COLORADO REVISED STATUTES

TITLES 4-6

2012

Colorado
Revised Statutes
2012

Titles 4-6
Uniform Commercial Code
Consumer Credit Code
Consumer and Commercial Affairs

♦♦♦

Edited, Collated, Revised,
Annotated, and Indexed
Under the Supervision and Direction of the

COMMITTEE ON LEGAL SERVICES
by
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Reenacted by the General Assembly as the
Positive Statutory Law of Colorado of a General and Permanent Nature
and as the Official Statutes of the State of Colorado

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CONTENT OF 2012
COLORADO REVISED STATUTES

CERTIFICATION
OF
COMMITTEE ON LEGAL SERVICES

The Committee on Legal Services hereby certifies that the 2012 Colorado Revised Statutes includes all the laws of a general and permanent nature of the state of Colorado as revised and reenacted in Colorado Revised Statutes 1973, together with all of the laws of a general and permanent nature enacted by the General Assembly subsequent to 1973, as corrected, collated, and revised as authorized by and in conformity with Article 5 of Title 2, Colorado Revised Statutes.

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TABLE OF CONTENTS

Source Note Information

A source note shows the legislative history of a C.R.S. section and is located immediately after the text of the section. The source note for each section indicates the year the section was added, each year it was amended, and the page of the Session Laws and the section of the bill where the amendment can be found. The source note includes the number of the section in prior codifications when applicable. For amendments made after 1973, information on each specific provision of the section that has been changed by a bill, the specific change to the provision (i.e. added, added with relocations, amended, amended with relocations, repealed, repealed and reenacted, or recreated and reenacted), and the effective date of the bill are shown.

The legislative history is arranged by year of passage; if the section was amended by two or more acts in the same year, the order of the information for that year is determined by the effective dates of the acts. The effective date in the source note indicates the date the act or portion of the act takes effect even if the text of the amendment indicates a different date. If the year is not included with the month and day, the provision is effective the year of passage. Additional information to assist the user in researching C.R.S. sections can be found beginning on page vii.

The following provides a further explanation of the information found in a source note:

"L." is the symbol for "Session Laws" and will be followed by a number indicating the year when the C.R.S. section was changed by an act generally either creating new law, amending existing law, or repealing existing law; except that, in the constitution, "L." also means constitutional measures referred by the General Assembly and voted on by the people of Colorado at a general or an odd-year election.

"Ex. Sess." is the symbol for "Extraordinary Session". If this symbol follows the year, the amended provision can be found in the Session Laws for an extraordinary session for that year and not in the Session Laws for the regular session of the General Assembly for that year (S, S2 in the Red Book).

"p." is the symbol for "page" and will be followed by a number indicating the page of the Session Laws where the amendment to the C.R.S. section can be found.

"§" is the symbol for "section" and will be followed by a number indicating the section of the act where the amendment to the C.R.S. section can be found.

"IP" is the symbol for the "introductory portion" to a section, subsection, paragraph, or subparagraph.

"Added" means the provision was newly enacted by the act (N in the Red Book).

"Added with relocations" means the provision in existing law was relocated from one title, article, part, or section to another title, article, part, or section with amendments by the act.

"Amended" means the provision in existing law was amended by the act (A in the Red Book).

"Amended with relocations" means the provision in existing law was amended to reorganize an entire title, article, part, or section by the act.

"Repealed" means the provision was deleted from the existing law by the act through the use of a repeal provision (R in the Red Book).

"R&RE" is the symbol for "Repealed and Reenacted" and means the provision in existing law was repealed and reenacted by the act (RE in the Red Book).

"RC&RE" is the symbol for "Recreated and Reenacted" and means a previously repealed provision has been recreated by the act (RC in the Red Book).

"Added by revision" means a provision providing for the repeal of a statutory provision on a specified date has been added by the Revisor of Statutes as a C.R.S. provision. Adding the provision is necessary because a separate section of the act provided for the repeal of the provision with a future effective date.

"Initiated" means a provision that was amended by means of an initiated petition approved by a vote of the people of Colorado at a general or an odd-year election.

"Referred" means a provision that was amended by a measure referred by the General Assembly and voted on by the people of Colorado at a general or an odd-year election; except that, in the constitution, a referred measure is indicated by "L." and also means constitutional measures referred by the General Assembly and voted on by the people of Colorado at a general or an odd-year election.

Starting in 2009, references to the bill number and chapter number have been included in the source note. If you are conducting a search on-line, the bill number reference within the source note links directly to the bill itself.

Colorado Statutory Research

Legislative history is not already written. It must be compiled by the researcher from many different sources and materials. The following information is a helpful starting point in identifying information you wish to research. Consult the red book table distributed with the session laws, the softbound editions of Colorado Revised Statutes beginning in 1997, the comparative tables located in the back of the C.R.S. index, C.R.S. 1963 and subsequent cumulative supplements thereto through 1971, and C.R.S. 1973 and annual cumulative supplements thereto through 1996.

Prior to 1921, enacted laws were not compiled into a comparative table, thereby making it more difficult to track the legislative history. Determining the subject matter in the statutory index is the only choice for tracking the history of a statute since a statute did not retain its original number. The General Statutes of 1883 arranged laws into numbered chapters, alphabetically entitled, collated, and arranged by sections. This became the foundation and

model for compiling the statutes until the codification of C.R.S. 1973. (See Revised Statutes of Colorado 1908, An Act Providing For the Compilation, Publication, and Distribution of all the general statutes of the state.)

References in some source notes throughout the Colorado Revised Statutes to "Code 08", "Code 21", and "Code 35" are to the Revised Statutes of Colorado 1908, the Compiled Laws of Colorado 1921, and the Colorado Statutes Annotated 1935, respectively. Each of these volumes set forth the general statutes of the state of Colorado, including the Code of Civil Procedure and, in 1935, the Colorado Supreme Court Rules. On January 6, 1941, the Colorado Supreme Court adopted the new Rules of Civil Procedure, which became effective on April 6, 1941, resulting in the publication of a replacement volume. Thereafter, the publication of the Colorado Court Rules, although a continuing part of the Colorado Revised Statutes, contained a combination of the Federal Rules and the Colorado Code of Civil Procedure and, in addition, included some provisions that were entirely distinct from both the Federal Rules and the Colorado Code of Civil Procedure, as adopted or amended by the Supreme Court of Colorado.

To research a statute as it existed in previous years, the following is a chronological list of C.R.S. publications and the correct citation for each publication.

Revised Statutes of Colorado	(1868)	R.S.
General Laws of Colorado	(1877)	G.L.
General Statutes of Colorado	(1883)	G.S.
Revised Statutes of Colorado	(1908)	R.S. 08
Compiled Laws of Colorado	(1921)	C.L.
Colorado Statutes Annotated	(1935)	CSA
Colorado Revised Statutes 1953	(1953)	CRS 53
Colorado Revised Statutes 1963	(1963)	C.R.S. 1963
Colorado Revised Statutes	(1973)	C.R.S.

Comparative Tables:
R.S. 08 to C.L. 1921 - located in the front of the C.L. 1921
C.L. 1921 to CSA 1935 - located in the back of the Index to CSA 1935
CSA 1935 to CRS 1953 - located in the front of the Index to CRS 1953
CRS 1953 to C.R.S. 1963 - located in the front of the Index to C.R.S. 1963
C.R.S. 1963 to C.R.S. - located in the back of the Index to C.R.S.

Supplements to C.R.S. 1963 include:
1965 hardbound supplement containing laws enacted in 1964 and 1965
1967 hardbound supplement containing laws enacted in 1966 and 1967
1969 hardbound supplement containing laws enacted in 1968 and 1969
1971 hardbound supplement containing laws enacted in 1970 and 1971

The softbound publication of the "Official Report of the Committee on Legal Services" was not intended as an official publication of our office. Copies were distributed to the members of the General Assembly for the purpose of certifying the laws enacted in the 1972 and 1973 Sessions for inclusion in the compilation of the 1973 C.R.S., which was not available until 1974. To find the 1972 or 1973 amended language, refer to the session laws of either 1972 or 1973.

Supplements and Replacement Volumes to C.R.S. 1973 and, on and after 1983, to Colorado Revised Statutes

Titles	Supplements to C.R.S. 1973 and, on and after 1983, to Colorado Revised Statutes	Replacement Volumes and Supplements to Replacement Volumes
Titles 4, 5, & 6	1974-91 Supplements	**1992 Replacement Volume** 1993-96 Supplements

Starting in 1997, annual softbound volumes are published each year.

For additional information on researching legislative history, see www.leg.state.co.us, Services Agencies, and select Legislative Legal Services. Choose Legal Topics and click on Researching Legislative History.

Bills Enacted Without A Safety Clause Explanation of Effective Date

If a bill is enacted without a safety clause and an effective date is not indicated in the bill, the effective date is the day following the expiration of the ninety-day period after final adjournment of the General Assembly that is allowed for submitting a referendum petition pursuant to article V, section 1 (3) of the state Constitution unless a referendum petition is filed against the act within such time period. If a referendum petition is filed, the act, if approved by the people, will take effect on the date of the official declaration of the vote thereon by proclamation of the Governor or the date indicated in the act if it is later than the Governor's proclamation. The source note for a provision contained in such an act will indicate the actual date following the ninety-day period or the date set out in the act. If a referendum petition is filed, the date in the source note will be adjusted accordingly in the next publication following the election where the referendum petition is considered.

Annotations

Beginning in 2012, the annotations for Colorado state appellate court decisions include both public domain and regional reporter case cites. In preparing annotations to court decisions, we endeavor to include the most recent decisions. Occasionally, this may result in the inclusion of a decision before it becomes finalized and published in an official reporter. In such instances, the case cite will contain blank spaces for the volume and page number of the reporter. The volume and page number will be substituted for the blank spaces in subsequent publications of the statutes.

TITLE 4

UNIFORM COMMERCIAL CODE

TITLE 4

UNIFORM COMMERCIAL CODE

Official Comments

Editor's note: The Official Comments to the Uniform Commercial Code are available only in the printed book form of Colorado Revised Statutes. As noted above, the Official Comments are subject to copyright by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. At this time, Colorado has a license to reprint the Official Comments in the printed book form.

ARTICLE 1

General Provisions

Editor's note: This article was numbered as article 1 of chapter 155, C.R.S. 1963. The provisions of this article were repealed and reenacted in 2006, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 2006, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated.

Law reviews: For article, "Commercial Law", which discusses Tenth Circuit decisions dealing with commercial law, see 61 Den. L.J. 205 (1984); for article, "Commercial Law", which discusses Tenth Circuit decisions dealing with commercial law, see 62 Den. U. L. Rev. 79 (1985); for article, "Commercial and Corporate Law" which discusses Tenth Circuit decisions dealing with commercial law, see 64 Den. U. L. Rev. 165 (1987); for comment, "Bad Faith Lenders", see 60 U. Colo. L. Rev. 417 (1989); for a discussion of Tenth Circuit decisions dealing with commercial law, see 67 Den. U. L. Rev. 649 (1990).

OFFICIAL COMMENT

I. Introduction

From its inception, the Article 1 Drafting Committee performed two related, but distinct, tasks — revision of the current text of Uniform Commercial Code Article 1 and harmonization of ongoing UCC projects. This draft represents the product of one of those tasks — revision of the provisions of Article 1. The other task entailed the Drafting Committee serving as a harmonization committee for the purpose of seeking to insure that the Uniform Commercial Code speaks with a single voice to the extent appropriate.

After lengthy analysis and discussion, the Drafting Committee decided to recommend a relatively small number of substantive changes to the law as it is currently set forth in Article 1. Those changes, concerning scope of the Article, applicability of supplemental principles of law, the concept of good faith, choice of law, the relevance of course of performance between the parties, and the existence of an independent statute of frauds, are described in some detail in Part II below. The changes with respect to choice of law are probably the most important changes in this draft and were the subject of more extensive Drafting Committee analysis and deliberation than any other topic.

In addition to these substantive changes, the Drafting Committee decided to make some structural changes to Article 1. These structural changes, intended to make this Article more closely fit with the drafting conventions of the more recently addressed Articles and to lessen some difficulties in interpretation, are described in Part III below. Other than these structural changes, the Drafting Committee generally decided to resist the temptation to make nonsubstantive changes to provisions that have not been a source of serious problems in the nearly four decades since the widespread enactment of the UCC. A few such changes should be noted, however. First, as in all of the other UCC Articles promulgated in the last decade, provisions have been reformulated in a gender-neutral fashion. Second, in a very small number of cases, minor changes in wording have been made when the current wording has proven confusing. Those changes are noted in the Official Comments following each section but are not otherwise described in this Prefatory Note.

II. Substantive Issues

The following are significant substantive issues raised by changes from current Article 1, in the order of their appearance in the draft:

A. Scope

Article 1 contains a relatively small number of substantive rules, but those rules are of fundamental importance. Occasionally courts and commentators have expressed uncertainty as to which transactions are governed by the substantive rules. Section 1-102 expresses a point that is implicit in current Article 1 — namely, that the substantive rules in Article 1 apply only to transactions within the scope of the other Articles.

B. Applicability of Supplemental Principles of Law

This draft merges subsections (1) and (2) of current Section 1-102 (concerning the underlying purposes and policies of the UCC) and current Section 1-103 (concerning the applicability of supplemental principles of law) into a revised Section 1-103. The provisions have been combined in this Section to reflect the interrelationship between the Code's purposes and policies and the extent to which other law is available to supplement it. Except for changing the form of reference to the Uniform Commercial Code, subsection (b) of this Section is identical to current Section 1-103. The revised Official Comments to this Section, though, give more helpful guidance as to the distinction between situations in which Code provisions preempt the application of other law and those in which such supplementation is permissible.

C. Good Faith

Section 1-201(19) replaces the current definition of "good faith" ("honesty in fact in the conduct or transaction concerned") with the definition adopted by all but one of the recently revised UCC Articles as well as drafts of Revised Articles 2 and 2A — "honesty in fact and the observance of reasonable commercial standards of fair dealing." The Section explicitly provides, however, that its definition of "good faith" is subordinate to the narrower definition in UCC Article 5. In addition to centralizing the developments already taking place in other Articles, the new definition resolves any ambiguity as to the proper definition to apply to the general duty of good faith imposed by Article 1.

D. Choice of Law

Section 1-301 represents a significant rethinking of choice of law issues addressed in current UCC Section 1-105. The new section reexamines both the power of parties to select the jurisdiction whose law will govern their transaction and the determination of the governing law in the absence of such selection by the parties. With respect to the power to select governing law, the draft affords greater party autonomy, but with important safeguards protecting consumer interests and fundamental policies. While the Drafting Committee considered also addressing the related topic of forum selection clauses, it ultimately decided that there was no need for uniform commercial law to govern such clauses.

1. Contractual Designation of Governing Law

Revised UCC section 1-301 addresses contractual designation of governing law somewhat differently than does current section 1-105. Current law allows the parties to any transaction to designate a jurisdiction whose law governs if the transaction bears a "reasonable relation" to that jurisdiction. Revised Article 1 deviates from this unified approach by providing different rules for consumer transactions than for "business to business" transactions.

In the context of consumer transactions, revised Article 1, unlike current law, protects consumers against the possibility of losing the protection of consumer protection laws of their home jurisdiction.

In the context of business-to-business transactions, revised Article 1 generally provides the parties with greater autonomy to designate a jurisdiction whose law will govern than does current Article 1, but also provides some safeguards against abuse that do not appear in current Article 1. Following emerging international norms, greater autonomy is provided in subsections (b) and (c) by deleting the requirement that the transaction bear a "reasonable relation" to the jurisdiction designated in this non-consumer context. It should be noted in this regard that in the case of wholly domestic transactions the jurisdiction designated must be a State. An important safeguard not present in current law is provided in subsection (e). Subsection (e) indicates that the designation of a jurisdiction's law is not effective (even if the transaction bears a reasonable relation to that jurisdiction) to the extent that application of that law would be contrary to a fundamental policy of the jurisdiction whose law would govern in the absence of contractual designation. Application of the law designated may be contrary to a fundamental policy of the State or country whose law would otherwise govern either because of the nature of the law designated or because of the "mandatory" nature of the law that would otherwise apply.

2. Choice of Law in the Absence of Contractual Designation of Governing Law

In the absence of an effective contractual designation of governing law, current UCC section 1-105(1) directs the forum to apply its own law if the transaction bears "an appropriate relation to this state." This provision, however, is frequently ignored by courts. Revised UCC section 1-301(b) provides simply that, in the absence of contractual designation, the court should apply the forum's choice of law principles.

E. Course of Performance

Section 1-304 adds the concept of "course of performance," currently utilized only in Articles 2 and 2A, to course of dealing and usage of trade as the contextual clues that a court may use to interpret a contract.

F. Statute of Frauds

The Statute of Frauds "for kinds of personal property not otherwise covered" that appears in current Section 1-206 has been deleted. The Drafting Committee noted that the other Articles of the Uniform Commercial Code make individual determinations as to writing requirements for transactions within their scope, so that the only effect of Section 1-206 was to impose a

writing requirement on transactions not otherwise governed by the UCC. The Drafting Committee decided that it is inappropriate for Article 1 to impose such writing requirements.

III. Structural Issues

A. General Organization

Current Article 1 is divided into two parts. Part 1 is entitled "Short Title, Construction, Application and Subject Matter of Act." Part 2 is entitled "General Definitions and Principles of Interpretation." The rationale for placement of particular sections in one part or the other is occasionally obscure. This draft reorganizes Article 1 into three parts. Part 1 — "General Provisions" — contains general rules about the UCC as a whole. Part 2 — "General Definitions and Principles of Interpretation" — contains the Code's major definitional section as well as additional rules of interpretation. Part 3 — "Territorial Applicability and General Rules" — contains substantive rules that apply to all transactions that are within the scope of the Code.

B. Relocation of Substantive Rules Embedded in Definitions

The Drafting Committee identified four cases in which definitions in Section 1-201 were made unnecessarily complicated by substantive rules embedded within them. Extracting those substantive rules and placing them in their own sections enables those rules to be presented more effectively and is more consistent with current drafting principles in many states.

1. Notice and knowledge

The rules concerning notice and knowledge have been moved from their current location in three subsections of Section 1-201 to a separate substantive section. The Drafting Committee believes that the concepts are more clearly articulated in this fashion.

2. Distinguishing leases from security interests

In current Article 1, the definition of "security interest" consists of a short paragraph elucidating a basic principle that resolves almost every issue, followed by over 50 lines of clarification and qualification that serve only one function — distinguishing "true leases" from transactions that are leases in form but security interests in substance. This extended rule even contains a nested definition of the term "present value," which it uses as part of drawing the distinction between true leases and security interests. The portion of the definition of "security interest" that distinguishes true leases from security interests has been moved to a separate substantive section. As a result, the remaining portion of the definition of "security interest" is shorter and clearer. The definition of "present value" is moved to its own definitional subsection.

3. Value

Whether a person acquires rights "for value" is at present the subject of a definitional provision in current Section 1-201(44). Yet, as the NCCUSL Committee on Style correctly noted to the Drafting Committee, the provision is more appropriately articulated as a free- standing rule. It has been moved to Section 1-204.

PART 1

GENERAL PROVISIONS

4-1-101. Short titles. (a) This title shall be known and may be cited as the "Uniform Commercial Code".

(b) This article shall be known and may be cited as the "Uniform Commercial Code - General Provisions".

Source: L. 2006: Entire article R&RE, p. 457, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-101 as it existed prior to 2006.

Cross references: For offenses relating to the uniform commercial code, see §§ 18-5-501 to 18-5-512.

OFFICIAL COMMENT

Source: Former Section 1-101.

Changes from former law: Subsection (b) is new. It is added in order to make the structure of Article 1 parallel with that of the other Articles of the Uniform Commercial Code.

1. Each other Article of the Uniform Commercial Code (except Articles 10 and 11) may also be cited by its own short title. See Sections 2-101, 2A-101, 3-101, 4-101, 4A-101, 5-101, 6-101, 7-101, 8-101 and 9-101.

ANNOTATION

Law reviews. For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965). For list of Colorado general assembly changes in the Uniform Commercial Code, see 38 U. Colo. L. Rev. 2 (1965).

4-1-102. Scope of article. This article applies to a transaction to the extent that it is governed by any other article of this title.

Source: L. 2006: Entire article R&RE, p. 457, § 1, effective September 1.

OFFICIAL COMMENT

Source: New.

1. This section is intended to resolve confusion that has occasionally arisen as to the applicability of the substantive rules in this article. As this section makes clear, the rules in article 1 apply to transactions to the extent that those transactions are governed by one of the other articles of the Uniform Commercial Code. This article does not apply to transactions to the extent that they are governed by other law. See Official Comment 1 to Section 1-301.

4-1-103. Construction of act to promote its purposes and policies - applicability of supplemental principles of law. (a) This title shall be liberally construed and applied to promote its underlying purposes and policies, which are:

(1) To simplify, clarify, and modernize the law governing commercial transactions;

(2) To permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and

(3) To make uniform the law among the various jurisdictions.

(b) Unless displaced by the particular provisions of this title, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause shall supplement its provisions.

Source: L. 2006: Entire article R&RE, p. 457, § 1, effective September 1.

Editor's note: This section is similar to former §§ 4-1-102 (1) and (2) and 4-1-103 as they existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-102 (1)-(2); Former Section 1-103.

Changes from former law: This Section is derived from subsections (1) and (2) of former Section 1-102 and from former Section 1-103. Subsection (a) of this Section combines subsections (1) and (2) of former Section 1-102. Except for changing the form of reference to the Uniform Commercial Code and minor stylistic changes, its language is the same as subsections (1) and (2) of former Section 1-102. Except for changing the form of reference to the Uniform Commercial Code, subsection (b) of this Section is identical to former Section 1-103. The provisions have been combined in this Section to reflect the interrelationship between them.

1. The Uniform Commercial Code is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in the Uniform Commercial Code to be developed by the courts in the light of unforeseen and new circumstances and practices. However, the proper construction of the Uniform Commercial Code requires that its interpretation and application be limited to its reason.

Even prior to the enactment of the Uniform Commercial Code, courts were careful to keep broad acts from being hampered in their effects by later acts of limited scope. [Pacific Wool Growers v. Draper & Co., 158 Or. 1, 73 P.2d 1391 (1937), and] compare Section 1-104. The courts recognized the policies embodied in an act as applicable in reason to subject-matter that was not expressly included in the language of the act, [Commercial Nat. Bank of New Orleans v. Canal-Louisiana Bank & Trust Co., 239 U.S. 520, 36 S.Ct. 194, 60 L.Ed. 417 (1916) (bona

fide purchase policy of Uniform Warehouse Receipts Act extended to case not covered but of equivalent nature)] and did the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general. [Agar v. Orda, 264 N.Y. 248, 190 N.E. 479 (1934) (Uniform Sales Act change in seller's remedies applied to contract for sale of choses in action even though the general coverage of that Act was intentionally limited to goods "other than things in action.")] They implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They disregarded a statutory limitation of remedy where the reason of the limitation did not apply. [Fiterman v. J. N. Johnson & Co., 156 Minn. 201, 194 N.W. 399 (1923) (requirement of return of the goods as a condition to rescission for breach of warranty; also, partial rescission allowed).] Nothing in the Uniform Commercial Code stands in the way of the continuance of such action by the courts.

The Uniform Commercial Code should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Uniform Commercial Code as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

2. *Applicability of supplemental principles of law.* Subsection (b) states the basic relationship of the Uniform Commercial Code to supplemental bodies of law. The Uniform Commercial Code was drafted against the backdrop of existing bodies of law, including the common law and equity, and relies on those bodies of law to supplement it provisions in many important ways. At the same time, the Uniform Commercial Code is the primary source of commercial law rules in areas that it governs, and its rules represent choices made by its drafters and the enacting legislatures about the appropriate policies to be furthered in the transactions it covers. Therefore, while principles of common law and equity may *supplement* provisions of the Uniform Commercial Code, they may not be used to *supplant* its provisions, including the purposes and policies those provisions reflect, unless a specific provision of the Code provides otherwise. In the absence of such a provision, the Uniform Commercial Code preempts principles of common law and equity that are inconsistent with either its provisions, or its purposes and policies.

The language of subsection (b) is intended to reflect both the concept of supplementation and the concept of preemption. Some courts, however, had difficulty in applying the identical language of former Section 1-103 to determine when other law appropriately may be applied to supplement the Code, and when that law has been displaced by the Code. Some decisions applied other law in situations in which that application, while not inconsistent with the text of any particular provision of the Code, clearly was inconsistent with the underlying purposes and policies reflected in the relevant Code provisions. *See, e.g.,* Sheerbonnet, Ltd. v. American Express Bank, Ltd., 951 F. Supp. 403 (S.D.N.Y. 1995). In part, this difficulty arose from comment 1 to former Section 1-103, which stated that "this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act." The "explicitly displaced" language of that comment does not accurately reflect the proper scope of Code preemption, which extends to displacement of other law that is inconsistent with its purposes and policies as well as its text.

3. *Application of subsection (b) to statutes.* The primary focus of Section 1-103 is on the relationship between the Uniform Commercial Code and principles of common law and equity as developed by the courts. State law, however, increasingly is statutory. Not only are there a growing number of state statutes addressing specific issues that come within the scope of the Uniform Commercial Code, but in some states many general principles of common law and equity have been codified. When the other law relating to a matter within the scope of the Uniform Commercial Code is a statute, the principles of subsection (b) remain relevant to the court's analysis of the relationship between that statute and the Uniform Commercial Code, but will be supplemented by other principles of statutory interpretation that specifically address the interrelationship between statutes. In some situations, the principles of subsection (b) still will be determinative. For example, the mere fact that an equitable principle is stated in statutory form rather than in judicial decisions should not change the court's analysis of whether the principle can be used to supplement the Uniform Commercial Code — under subsection (b), equitable principles may supplement provisions of the Uniform Commercial Code only if they are consistent with the purposes and policies of the Uniform Commercial Code as well as its text. In other situations, however, other interpretive principles addressing the interrelationship between statutes may lead the court to conclude that the other statute is controlling, even though it conflicts with the Uniform Commercial Code. This, for example, would be the result in a situation where the other statute was specifically intended to provide additional protection to a class of individuals engaging in transactions covered by the Uniform Commercial Code.

4. *Listing not exclusive.* The list of sources of supplemental law in subsection (b) is in-

tended to be merely illustrative of the other law that may supplement the Uniform Commercial Code, and is not exclusive. No listing could be exhaustive. Further, the fact that a particular section of the Uniform Commercial Code makes express reference to other law is not intended to suggest the negation of the general application of the principles of subsection (b). Note also that the word "bankruptcy" in subsection (b), continuing the use of that word from former Section 1-103, should be understood not as a specific reference to federal bankruptcy law but, rather as a reference to general principles of insolvency, whether under federal or state law.

ANNOTATION

Law reviews. For article, "Exclusion and Modification of Warranty under the U.C.C. — How to Succeed in Business Without Being Liable for Not Really Trying", see 46 Den. L.J. 579 (1969). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Annotator's note. Since § 4-1-103 is similar to §§ 4-1-102 and 4-1-103 as they existed prior to the 2006 repeal and reenactment of this article, relevant cases construing those provisions have been included in the annotations to this section.

The parties to a contract may vary the provisions of the Uniform Commercial Code by agreement and may provide for remedies in addition to or in substitution for those provided by the Uniform Commercial Code. Colorado Interstate Gas Co. v. Chemco, Inc., 854 P.2d 1232 (Colo. 1993).

Section 90(1) of the restatement (second) of contracts adopted, which articulates the doctrine of promissory estoppel. Kiely v. St. Germain, 670 P.2d 764 (Colo. 1983).

The UCC does not exclude the application of promissory estoppel. Germain v. Boshouwers, 646 P.2d 952 (Colo. App. 1982), aff'd in part and rev'd in part on other grounds, 670 P.2d 764 (Colo. 1983).

Recovery will be allowed on a theory of promissory estoppel, notwithstanding a statute of frauds defense, if injustice can be avoided only by enforcement of the promise. Germain v. Boshouwers, 646 P.2d 952 (Colo. App. 1982), aff'd in part and rev'd in part on other grounds, 670 P.2d 764 (Colo. 1983).

Elements of promissory estoppel are: (1) A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee; and (2) which does induce such action or forbearance; and (3) if injustice can be avoided only by enforcement of the promise. Germain v. Boshouwers, 646 P.2d 952 (Colo. App. 1982), aff'd in part and rev'd in part on other grounds, 670 P.2d 764 (Colo. 1983).

The doctrine of estoppel was properly applied in a case arising under the secured transaction provisions of the code. First Nat'l Bank v. Ulibarri, 38 Colo. App. 428, 557 P.2d 1221 (1976).

Detrimental reliance upon oral promises. The principle embodied in section 139 of the restatement (second) of contracts that detrimental action performed in justifiable reliance upon oral promises may be sufficient to compel full or partial performance of the promise in spite of the applicability of a statute of frauds defense was applicable in a case involving an oral agreement to sell securities. Kiely v. St. Germain, 670 P.2d 764 (Colo. 1983).

Section 4-3-419 (3) does not explicitly displace common-law cause of action for moneys had and received. Citizens State Bank v. Nat'l Sur. Corp., 199 Colo. 497, 612 P.2d 70 (1980).

Common-law claim for money had and received is still viable since the uniform commercial code contains no provision dealing with such a claim. Nat'l Sur. Corp. v. Citizens State Bank, 41 Colo. App. 580, 593 P.2d 362 (1978), aff'd, 199 Colo. 497, 612 P.2d 70 (1980).

Statute as basis for jurisdiction. Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

Applied in Rancher & Farmers Livestock Auction Co. v. Honey, 38 Colo. App. 69, 552 P.2d 313 (1976); Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976); Caldwell v. Kats, 38 Colo. App. 156, 555 P.2d 190 (1976); Commercial Credit Corp. v. Univ. Nat'l Bank, 590 F.2d 849 (10th Cir. 1979); Colorado-Ute Elec. Ass'n v. Envirotech Corp., 524 F. Supp. 1152 (D. Colo. 1981).

4-1-104. Construction against implied repeal. This title being a general act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided.

Source: L. 2006: Entire article R&RE, p. 458, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-104 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-104.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this Section is identical to former UCC Section 1-104.

1. This section embodies the policy that an act that bears evidence of carefully considered permanent regulative intention should not lightly be regarded as impliedly repealed by subsequent legislation. The Uniform Commercial Code, carefully integrated and intended as a uniform codification of permanent character covering an entire "field" of law, is to be regarded as particularly resistant to implied repeal.

4-1-105. Severability. If any provision or clause of this title or application thereof to any person or circumstances is held invalid, such invalidity does not affect other provisions or applications of this title that can be given effect without the invalid provision or application, and to this end the provisions of this title are declared to be severable.

Source: L. 2006: Entire article R&RE, p. 458, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-108 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-108.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this Section is identical to former UCC Section 1-108.

1. This is the model severability section recommended by the National Conference of Commissioners on Uniform State Laws for inclusion in all acts of extensive scope.

4-1-106. Use of singular and plural - gender. In this title, unless the statutory context otherwise requires:

(1) Words in the singular number include the plural, and those in the plural include the singular; and

(2) Words of any gender also refer to any other gender.

Source: L. 2006: Entire article R&RE, p. 458, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-102 (5) as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-102(5). See also 1 U.S.C. § 1.

Changes from former law: Other than minor stylistic changes, this Section is identical to former UCC section 1-102(5).

1. This section makes it clear that the use of singular or plural in the text of the Uniform Commercial Code is generally only a matter of drafting style — singular words may be applied in the plural, and plural words may be applied in the singular. Only when it is clear from the statutory context that the use of the singular or plural does not include the other is this rule inapplicable. See, e.g., Section 9-322.

4-1-107. Captions. Section captions are part of this title.

Source: L. 2006: Entire article R&RE, p. 458, § 1, effective September 1.

OFFICIAL COMMENT

Source: Former Section 1-109.

Changes from former law: None.

1. Section captions are a part of the text of the Uniform Commercial Code, and not mere surplusage. This is not the case, however, with respect to subsection headings appearing in Ar-

ticle 9. See Official Comment 3 to Section 9-101 ("subsection headings are not a part of the official text itself and have not been approved by the sponsors.").

PART 2

GENERAL DEFINITIONS AND PRINCIPLES OF INTERPRETATION

4-1-201. General definitions. (a) Unless the context otherwise requires, words or phrases defined in this section, or in the additional definitions contained in other articles of this title that apply to particular articles or parts thereof, have the meanings stated.

(b) Subject to definitions contained in other articles of this title that apply to particular articles or parts thereof:

(1) "Action", in the sense of a judicial proceeding, includes recoupment, counterclaim, set-off, suit in equity, and any other proceeding in which rights are determined.

(2) "Aggrieved party" means a party entitled to pursue a remedy.

(3) "Agreement" means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in section 4-1-303. (Compare "contract".)

(3.5) "Authenticate" means:

(A) To sign; or

(B) With the intent to sign a record, otherwise to execute or adopt an electronic symbol, sound, message, or process referring to, attached to, included in, or logically associated or linked with, that record.

(4) "Bank" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company.

(5) "Bearer" means a person in control of a negotiable electronic document of title or a person in possession of a negotiable instrument, negotiable tangible document of title, or certificated security that is payable to bearer or indorsed in blank.

(6) "Bill of lading" means a document of title evidencing the receipt of goods for shipment issued by a person engaged in the business of directly or indirectly transporting or forwarding goods. The term does not include a warehouse receipt.

(7) "Branch" includes a separately incorporated foreign branch of a bank.

(8) "Burden of establishing" a fact means the burden of persuading the trier of fact that the existence of the fact is more probable than its nonexistence.

(9) "Buyer in ordinary course of business" means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices. A person that sells oil, gas, or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under article 2 of this title may be a buyer in ordinary course of business. A person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt is not a buyer in ordinary course of business.

(10) "Conspicuous", with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. Whether a term is "conspicuous" or not is a decision for the court. Conspicuous terms include the following:

(A) A heading in capital letters equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and

(B) Language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from

surrounding text of the same size by symbols or other marks that call attention to the language.

(10.5) "Consumer" means an individual who enters into a transaction primarily for personal, family, or household purposes.

(11) "Contract" means the total legal obligation that results from the parties' agreement as determined by this title as supplemented by any other applicable laws. (Compare "agreement".)

(12) "Creditor" includes a general creditor, a secured creditor, a lien creditor, and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity, and an executor or administrator of an insolvent debtor's or assignor's estate.

(13) "Defendant" includes a person in the position of defendant in a counterclaim or third-party claim.

(14) "Delivery", with respect to an electronic document of title, means voluntary transfer of control and with respect to an instrument, a tangible document of title, or chattel paper, means voluntary transfer of possession.

(15) "Document of title" means a record (i) that in the regular course of business or financing is treated as adequately evidencing that the person in possession or control of the record is entitled to receive, control, hold, and dispose of the record and the goods the record covers and (ii) that purports to be issued by or addressed to a bailee and to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass. The term includes a bill of lading, transport document, dock warrant, dock receipt, warehouse receipt, and order for delivery of goods. An electronic document of title means a document of title evidenced by a record consisting of information stored in an electronic medium. A tangible document of title means a document of title evidenced by a record consisting of information that is inscribed on a tangible medium.

(16) "Fault" means a wrongful act, omission, breach, or default.

(17) "Fungible goods" means either:

(A) Goods of which any unit, by nature or usage of trade, is the equivalent of any other like unit; or

(B) Goods that by agreement are treated as equivalent.

(18) "Genuine" means free of forgery or counterfeiting.

(19) "Good faith", except as provided in article 5 of this title, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(20) "Holder" means:

(A) The person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession;

(B) The person in possession of a negotiable tangible document of title if the goods are deliverable either to bearer or to the order of the person in possession; or

(C) The person in control of a negotiable electronic document of title.

(21) "Insolvency proceeding" includes an assignment for the benefit of creditors or other proceeding intended to liquidate or rehabilitate the estate of the person involved.

(22) An "insolvent" person is a person that:

(A) Has generally ceased to pay debts in the ordinary course of business other than as a result of a bona fide dispute as to the debts;

(B) Is unable to pay debts as they become due; or

(C) Is insolvent within the meaning of federal bankruptcy law.

(23) "Money" means a medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more countries.

(24) "Organization" means a person other than an individual.

(25) "Party", as distinct from a "third party", means a person that has engaged in a transaction or made an agreement subject to this title.

(26) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, government subdivision, agency, or instrumentality, or any other legal or commercial entity.

(27) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain by use of either an interest rate specified by the parties if that rate is not manifestly unreasonable at the time the transaction is entered into or, if an interest rate is not so specified, a commercially reasonable rate that takes into account the facts and circumstances at the time the transaction is entered into.

(28) "Presumption" or "presumed" means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced that would support a finding of its nonexistence.

(29) "Purchase" means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property.

(30) "Purchaser" means a person that takes by purchase.

(31) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(32) "Remedy" means any remedial right to which an aggrieved party is entitled, with or without resort to a tribunal.

(33) "Representative" means any person empowered to act for another, including an agent, an officer of a corporation or association, and a trustee, executor, or administrator of an estate.

(34) "Right" includes remedy.

(35) "Security interest" means an interest in personal property or fixtures that secures payment or performance of an obligation. The term also includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to article 9 of this title. The special property interest of a buyer of goods on identification of those goods to a contract for sale under section 4-2-401 is not a "security interest", but a buyer may also acquire a "security interest" by complying with article 9 of this title. Except as otherwise provided in section 4-2-505, the right of a seller or lessor of goods under article 2 or 2.5 of this title to retain or acquire possession of the goods is not a "security interest", but a seller or lessor may also acquire a "security interest" by complying with article 9 of this title. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (section 4-2-401) is limited in effect to a reservation of a "security interest". Whether a transaction in the form of a lease creates a "security interest" is determined pursuant to section 4-1-203.

(36) "Send", in connection with a writing, record, or notice, means to:

(A) Deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and, in the case of an instrument, to an address specified thereon or otherwise agreed, or, if there is none, to any address reasonable under the circumstances; or

(B) In any other way cause to be received any record or notice within the time it would have arrived if properly sent.

(37) "Signed" includes any symbol executed or adopted with present intention to adopt or accept a writing.

(38) "State" means a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(39) "Surety" includes a guarantor or other secondary obligor.

(40) "Term" means a portion of an agreement that relates to a particular matter.

(41) "Unauthorized signature" means a signature made without actual, implied, or apparent authority. The term includes a forgery.

(42) "Warehouse receipt" means a document of title issued by a person engaged in the business of storing goods for hire.

(43) "Writing" includes printing, typewriting, or any other intentional reduction to tangible form. "Written" has a corresponding meaning.

Source: L. 2006: Entire article R&RE, p. 458, § 1, effective September 1. **L. 2007:** (b)(5), (b)(15), (b)(20)(A), and (b)(20)(C) amended, p. 374, § 26, effective August 3.

Editor's note: This section is similar to former § 4-1-201 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-201.

Changes from former law: In order to make it clear that all definitions in the Uniform Commercial Code — not just those in Article 1 — do not apply if the context otherwise requires, a new subsection (a) to that effect has been added. The reference to the "context" is intended to refer to the context in which the defined term is used in the UCC. In other words, the definition applies whenever the defined term is used unless the context in which the defined term is used in the statute indicates that the term was not used in its defined sense. Consider, for example, UCC §§ 3-103(a)(9) (defining "promise," in relevant part, as "a written undertaking to pay money signed by the person undertaking to pay") and 3-303(a)(1) (indicating that an instrument is issued or transferred for value if "the instrument is issued or transferred for a promise of performance, to the extent that the promise has been performed." It is clear from the statutory context of the use of the word "promise" in § 3-303(a)(1) that the term was not used in the sense of its definition in § 3-103(a)(9). Thus, the § 3-103(a)(9) definition should not be used to give meaning to the word "promise" in § 3-303(a). The remainder of former Section 1-201, as revised, now appears as subsection (b).

Other than minor stylistic changes, the definitions in this draft are as in former Article 1 (as amended, most recently, in conjunction with revisions to Article 9) except as noted below. It should be noted that numbering of existing definitions has been left constant even though some new definitions have been added to this section and some others have been moved to other sections.

1. "Action." Unchanged from former Section 1-201, which was derived from similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act.

2. "Aggrieved party." Unchanged from former Section 1-201.

3. "Agreement." Derived from former Section 1-201. As used in the Uniform Commercial Code the word is intended to include full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts thereof, and of any agreement permitted under the provisions of the Uniform Commercial Code to displace a stated rule of law. Whether an agreement has legal consequences is determined by applicable provisions of the Uniform Commercial Code and, to the extent provided in Section 1-103, by the law of contracts.

3a. "Authenticate." This is the standard definition of the term used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

4. "Bank." Derived from Section 4A-104.

5. "Bearer." Unchanged from former Section 1-201, which was derived from Section 191, Uniform Negotiable Instruments Law.

6. "Bill of Lading." Derived from former Section 1-201. The reference to airbills has been deleted as no longer necessary.

7. "Branch." Unchanged from former Section 1-201.

8. "Burden of establishing a fact." Unchanged from former Section 1-201.

9. "Buyer in ordinary course of business." Unchanged from former Section 1-201 (as amended in conjunction with the 1999 revisions to Article 9). The major significance of the phrase lies in Section 2-403 and in the Article on Secured Transactions (Article 9).

The first sentence of paragraph (9) makes clear that a buyer from a pawnbroker cannot be a buyer in ordinary course of business. The second sentence tracks Section 6-102(1)(m). It explains what it means to buy "in the ordinary course." The penultimate sentence prevents a buyer that does not have the right to possession as against the seller from being a buyer in ordinary course of business. Concerning when a buyer obtains possessory rights, see Sections 2-502 and 2-716. However, the penultimate sentence is not intended to affect a buyer's status as a buyer in ordinary course of business in cases (such as a "drop shipment") involving delivery by the seller to a person buying from the buyer or a donee from the buyer. The requirement relates to whether *as against the seller* the buyer or one taking through the buyer has possessory rights.

10. "Conspicuous." Derived from Section 2-103(a)(10). It states the general standard that to be conspicuous a term ought to be noticed by a reasonable person. Whether a term is conspicuous is an issue for the court. Subparagraphs (A) and (B) set out several methods for making a term conspicuous. Requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving guidance to the party relying on the term regarding how that result can be achieved). Although these paragraphs indicate some of the methods for making a term attention-calling, the test is whether attention can reasonably be expected to be called to it. The statutory language should not be construed to permit a result that is inconsistent with that test.

11. "Contract." Unchanged from former Section 1-201.

11a. "Consumer." Derived from Section 9-102(a)(25).

12. "Creditor." Unchanged from former Section 1-201.

13. "Defendant." Unchanged from former Section 1-201, which was derived from Section 76, Uniform Sales Act.

14. "Delivery." Derived from former Section 1-201. The reference to certificated securities has been deleted in light of the more specific treatment of the matter in Section 8-301.

15. "Document of title." Unchanged from former Section 1-201, which was derived from Section 76, Uniform Sales Act. By making it explicit that the obligation or designation of a third party as "bailee" is essential to a document of title, this definition clearly rejects any such result as obtained in Hixson v. Ward, 254 Ill.App. 505 (1929), which treated a conditional sales contract as a document of title. Also the definition is left open so that new types of documents may be included. It is unforeseeable what documents may one day serve the essential purpose now filled by warehouse receipts and bills of lading. Truck transport has already opened up problems which do not fit the patterns of practice resting upon the assumption that a draft can move through banking channels faster than the goods themselves can reach their destination. There lie ahead air transport and such probabilities as teletype transmission of what may some day be regarded commercially as "Documents of Title." The definition is stated in terms of the function of the documents with the intention that any document which gains commercial recognition as accomplishing the desired result shall be included within its scope. Fungible goods are adequately identified within the language of the definition by identification of the mass of which they are a part.

Dock warrants were within the Sales Act definition of document of title apparently for the purpose of recognizing a valid tender by means of such paper. In current commercial practice a dock warrant or receipt is a kind of interim certificate issued by steamship companies upon delivery of the goods at the dock, entitling a designated person to have issued to him at the company's office a bill of lading. The receipt itself is invariably nonnegotiable in form although it may indicate that a negotiable bill is to be forthcoming. Such a document is not within the general compass of the definition, although trade usage may in some cases entitle such paper to be treated as a document of title. If the dock receipt actually represents a storage obligation undertaken by the shipping company, then it is a warehouse receipt within this Section regardless of the name given to the instrument.

The goods must be "described," but the description may be by marks or labels and may be qualified in such a way as to disclaim personal knowledge of the issuer regarding contents or condition. However, baggage and parcel checks and similar "tokens" of storage which identify stored goods only as those received in exchange for the token are not covered by this Article.

The definition is broad enough to include an airway bill.

16. "Fault." Derived from former Section 1-201. "Default" has been added to the list events constituting fault.

17. "Fungible." Derived from former Section 1-201. The definition has been reorganized and references to securities have been deleted because Article 8 no longer uses the term "fungible" to describe securities.

18. "Genuine." Unchanged from former Section 1-201.

19. "Good faith." Former Section 1-201(19) defined "good faith" simply as honesty in fact; the definition contained no element of commercial reasonableness. Initially, that definition applied throughout the Code with only one exception. Former Section 2-103(1)(b) provided that *"in this Article . . .* good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." This alternative definition was limited in applicability in three ways. First, it applied only to transactions within the scope of Article 2. Second, it applied only to merchants. Third, strictly construed it applied only to uses of the phrase "good faith" *in Article 2;* thus, so construed it would not define "good faith" for its most important use — the obligation of good faith imposed by former UCC Section 1-203.

Over time, however, amendments to the UCC brought the Article 2 merchant concept of good faith (subjective honesty and objective reasonableness) into other Articles. First, Article 2A explicitly incorporated the Article 2 standard. See current UCC Section 2A-103(7). Then, other Articles broadened the applicability of that standard by adopting it for all parties rather than just for merchants. See, e.g., UCC Sections 3-103(a)(4), 4A-105(a)(6), 8-102(a)(10), and 9-102(a)(43). See also Draft of Revised Article 2. All of these definitions are comprised of two elements — honesty in fact *and* the observance of reasonable commercial standards of fair dealing. Only revised Article 5 defines "good faith" solely in terms of subjective honesty, and only Article 6 and Article 7 are without definitions of good faith. (It should be noted that, while revised Article 6 did not define good faith, Comment 2 to revised UCC section 6-102 states that "this Article adopts the definition of 'good faith' in Article 1 in all cases, even when the buyer is a merchant.") Given this near unanimity, it is appropriate to move the broader definition of "good faith" to Article 1. Of course, this definition is subject to the applicability of the narrower definition in revised Article 5.

20. "Holder." Derived from former Section 1-201. The definition has been reorganized for clarity.

22. "Insolvency proceedings." Unchanged from former Section 1-201.

23. "Insolvent." Derived from former Section 1-201. The three tests of insolvency — "generally ceased to pay debts in the ordinary course of business other than as a result of a bona fide dispute as to them," "unable to pay debts as they become due," and "insolvent within the meaning of the federal bankruptcy law" — are expressly set up as alternative tests and must be approached from a commercial standpoint.

24. "Money." Unchanged from former Section 1-201. The test is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.

28. "Organization." The former definition of this word has been replaced with the standard definition used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

29. "Party." Substantively identical to former Section 1-201. Mention of a party includes, of course, a person acting through an agent. However, where an agent comes into opposition or contrast to the principal, particular account is taken of that situation.

30. "Person." The former definition of this word has been replaced with the standard definition used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

30a. "Present value." This definition was formerly contained within the definition of "security interest" in former Section 1-201(37).

31. "Presumption." Unchanged from former Section 1-201.

32. "Purchase." Derived from former UCC Section 1-201. The form of definition has been changed from "includes" to "means."

33. "Purchaser." Unchanged from former Section 1-201.

33a. "Record." Derived from Section 9-102(a)(69).

34. "Remedy." Unchanged from former Section 1-201. The purpose is to make it clear that both remedy and right (as defined) include those remedial rights of "self help" which are among the most important bodies of rights under the Uniform Commercial Code, remedial rights being those to which an aggrieved party can resort on its own motion.

35. "Representative." Derived from former Section 1-201. Reorganized, and form changed from "includes" to "means."

36. "Right." Unchanged from former Section 1-201.

37. "Security Interest." The definition is the first paragraph of the definition of "security interest" in former Section 1-201. The remaining portion has been moved to Section 1-203. Notice that in view of Article 9 the term includes the interest of certain outright buyers of certain kinds of property.

38. "Send." New. Compare "notifies".

39. "Signed." Derived from former Section 1-201. Former Section 1-201 referred to "intention to authenticate"; because authenticate is now a defined term, the language has been changed to "intention to adopt or accept." The latter formulation is derived from the definition of "authenticate," The definition of "signed" is to make clear that, as the term is used in the Uniform Commercial Code, a complete signature is not necessary. The symbol may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible situations can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol was executed or adopted by the party with present intention to adopt or accept the writing.

39a. "State." This is the standard definition of the term used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

40. "Surety." This definition makes it clear that "surety" includes all secondary obligors, not just those whose obligation refers to them person obligated as a surety. As to the nature of secondary obligations generally, see Restatement of Suretyship and Guaranty § 1.

42. "Term." Unchanged from former Section 1-201.

43. "Unauthorized signature." Unchanged from former Section 1-201.

45. "Warehouse receipt." Unchanged from former Section 1-201, which was derived from Section 76(1), Uniform Sales Act; Section 1, Uniform Warehouse Receipts Act. Receipts issued by a field warehouse are included, provided the warehouseman and the depositor of the goods are different persons.

46. "Written" or "writing." Unchanged from former Section 1-201.

ANNOTATION

I. GENERAL CONSIDERATION.

Law reviews. For article, "Secured Transactions — Part 1: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Commercial Law", which discusses recent Tenth Circuit decisions dealing with questions of definition and interpretation, see 63 Den. U.L. Rev. 225 (1986). For article, "Criminal Law", which discusses recent Tenth Circuit decisions dealing with good faith defense, see 63 Den. U.L. Rev. 291 (1986).

Annotator's note. Since § 4-1-201 is similar to § 4-1-201 as it existed prior to the 2006 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Applied in Blake v. Samuelson, 34 Colo. App. 183, 524 P.2d 624 (1974); Budget Syst. v. Seifert Pontiac, Inc., 40 Colo. App. 406, 579 P.2d 87 (1978); State, Dept. of Natural Res. v. Benjamin, 41 Colo. App. 520, 587 P.2d 1207 (1978); Commercial Credit v. Univ. Nat'l Bank, 590 F.2d 849 (10th Cir. 1979); Western Nat'l Bank v. ABC Drilling Co., 42 Colo. App. 407, 599 P.2d 942 (1979); Jackson v. Sec. Indus. Bank, 4 Bankr. 293 (Bankr. D. Colo. 1980); Layne v. Fort Carson Nat'l Bank, 655 P.2d 856 (Colo. App. 1982); Ackmann v. Merchants Mtg. & Trust Corp., 659 P.2d 697 (Colo. App. 1982); Walgreen Co. v. Charnes, 859 P.2d 235 (Colo. App. 1992).

II. AGREEMENT.

Evidence of previous course of performance is admissible. Evidence of course of dealing and course of performance is admissible if it does not directly contradict the terms of a written agreement, but merely explains or supplements it. Great W. Sugar Co. v. N. Natural Gas Co., 661 P.2d 684 (Colo. App. 1982), aff'd sub nom. KN Energy, Inc. v. Great Western Sugar Co., 698 P.2d 769 (Colo. 1985), cert. denied, 472 U.S. 1022, 105 S. Ct. 3489, 87 L. Ed.2d 623 (1985).

Previous course of dealing considered in determining meaning of contract provisions. It is the policy of the uniform commercial code to consider previous course of dealing in determining the meaning of contract provisions. Amerine Nat'l Corp. v. Denver Feed Co., 493 F.2d 1275 (10th Cir. 1974).

After defendant was provided a copy of the manufacturer's statement and disclaimer of warranty, those items became part of the agreement between the parties. Graham Hydraulic v. Stewart & Stevenson, 797 P.2d 835 (Colo. App. 1990).

III. BUYER IN ORDINARY COURSE OF BUSINESS.

Homeowners who purchased materials kits from log home building firm were buyers in ordinary course of business and received title to materials when submaterialman made delivery and homeowners paid entrustee of goods. Lumber company, as submaterialman, has no ownership interest in or right to payment for materials delivered to homeowners. Schneider v. J. W. Metz Lumber Co., 715 P.2d 329 (Colo. 1986).

IV. CONSPICUOUS.

The term "conspicuous", as defined in subsection (10) of this section, is qualified by the provisions of § 4-2-316 (3). Richard O'Brien Cos. v. Challenge-Cook Bros., 672 F. Supp. 466 (D. Colo. 1987).

V. CREDITOR.

Applied in Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970).

VI. DOCUMENTS OF TITLE.

Bean company's drafts addressed to a bailee and purporting to cover goods in the bailee's possession, which were tangible portions of an identified mass, were "documents of title" under this section, since they were treated as such both by the parties themselves and were customarily so used in the bean business in general. Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976).

VII. GENUINE.

Stock certificates issued with facsimile signatures of corporate president and secretary are "genuine" under § 4-8-101 et seq., though not countersigned by a transfer agent as required by § 7-4-108. Dempsey-Tegeler & Co. v. Otis

Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

Even though certificates are issued without authority, it cannot be said that facsimile signatures are either forged or counterfeit, and so, in that sense, they are effective against the issuer. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

VIII. GOOD FAITH.

"Good faith" standard is a subjective one. Under a subjective standard, an absence of knowledge is not equivalent to a lack of good faith. Money Mart Check Cashing Ctr., Inc. v. Epicycle Corp., 667 P.2d 1372 (Colo. 1983).

"Good faith" unaffected by payee's low account. In the case of a bank cashing a check, if the bank establishes that the check was taken without notice of dishonor or of any other defense, this is sufficient to establish "good faith". The issue of good faith, to establish that the bank is a holder in due course, is unaffected by the fact that the payee's account is low or overdrawn at the time the check is cashed. Vail Nat'l Bank v. J. Wheeler Constr. Corp., 669 P.2d 1038 (Colo. App. 1983).

Evidence of purchaser's lack of good faith. Knowledge that the holder of a subordinate security interest had not been given the notice required by § 4-9-504 might be evidence of a want of good faith on the part of a purchaser. Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977).

Broker's disregard of suspicious circumstances is evidence of bad faith. First Nat'l Bank v. Gilbert Marshall, 780 P.2d 73 (Colo. App. 1989).

IX. HOLDER.

Law reviews. For note, "Judicial Limitations on Holder in Due Course Claims", see 42 U. Colo. L. Rev. 439 (1971).

Applied in Cole v. Farner, 749 P.2d 970 (Colo. App. 1987); Barclay Receivables v. Mountain Majesty, Ltd., 903 P.2d 37 (Colo. App. 1995).

X. PURCHASE.

Applied in Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

XI. PURCHASER.

Definition encompasses lender taking security interest in goods. The definition of "purchase" and "purchaser", as set forth in the UCC, are sufficiently broad to encompass a lender who takes a security interest in goods as security for its loan. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Applied in Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

XII. WRITTEN OR WRITING.

When parties to an oral contract agree that the oral contract shall be tape recorded, the contract is "reduced to tangible form" when it is placed on the tape. Ellis Canning Co. v. Bernstein, 348 F. Supp. 1212 (D. Colo. 1972).

4-1-202. Notice - knowledge. (a) Subject to subsection (f) of this section, a person has "notice" of a fact if the person:

(1) Has actual knowledge of it;

(2) Has received a notice or notification of it; or

(3) From all the facts and circumstances known to the person at the time in question, has reason to know that it exists.

(b) "Knowledge" means actual knowledge.

(c) "Discover", "learn", or words of similar import refer to knowledge rather than to notice.

(d) A person "notifies" or "gives" a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course, whether or not the other person actually comes to know of it.

(e) Subject to subsection (f) of this section, a person "receives" a notice or notification when:

(1) It comes to that person's attention; or

(2) It is duly delivered in a form reasonable under the circumstances at the place of business through which the contract was made or at another location held out by that person as the place for receipt of such communications.

(f) Notice, knowledge, or a notice or notification received by an organization is effective for a particular transaction from the time it is brought to the attention of the individual conducting that transaction and, in any event, from the time it would have been

brought to the individual's attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless the communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.

Source: L. 2006: Entire article R&RE, p. 463, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-201 (25) to (27) as it existed prior to 2006.

OFFICIAL COMMENT

Source: Derived from former Sections 1-201(25)-(27).

Changes from former law: These provisions are substantive rather than purely definitional. Accordingly, they have been relocated from Section 1-201 to this Section.

1. Under subsection (a), a person has notice when, *inter alia*, the person has received a notification of the fact in question. The subsection leaves open the time and circumstances under which notice or notification may cease to be effective. Therefore such cases as Graham v. White-Phillips Co., 296 U.S. 27, 56 S.Ct. 21, 80 L.Ed. 20 (1935), are not overruled.

2. As shown in subsection (d), the word "notifies" used when the essential fact is the proper dispatch of the notice, not its receipt. Compare "Send." When the essential fact is the other party's receipt of the notice, that is stated. Subsection (e) states when a notification is received.

3. Subsection (f) makes clear that reason to know, knowledge, or a notification, although "received" for instance by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction.

ANNOTATION

Annotator's note. Since § 4-1-202 is similar to § 4-1-201 (25), (26), and (27) as they existed prior to the 2006 repeal and reenactment of this article, relevant cases construing those provisions have been included in the annotations to this section.

There is no actual notice of the unauthorized issuance of stock certificates where it does not appear that one was aware of the provision in the Colorado law requiring that certificates issued with facsimile signatures of the president and the secretary be countersigned by a transfer agent when the certificates do not contain a statement that they are void unless countersigned by a transfer agent and it does not appear that there were facts or circumstances known which would have put one on notice of illegality issue or of the deficiency arising from the failure of the transfer agent to countersign them. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

Tests other than "actual knowledge" may be used in resolving the issue of whether an endorsee of a promissory note is a holder in due course, including whether the holder had in his possession facts from which he had reason to know of the defenses "at the time in question". The critical time for such notice is when the party comes into possession of the note as a holder. Salter v. Vanotti, 42 Colo. App. 448, 599 P.2d 962 (1979).

Inquiry required. If the purchaser has actual knowledge of facts which would apprise him of possible irregularities some inquiry is required by the notice provisions of the UCC. Salter v. Vanotti, 42 Colo. App. 448, 599 P.2d 962 (1979).

Inquiry not required. Where an instrument is regular on its face there is no duty on the part of a check cashing service to inquire as to possible defenses, unless circumstances of which the holder in due course has knowledge are of such a nature that the failure to inquire reveals a deliberate desire to evade knowledge because of a fear that investigation would disclose the existence of a defense. Money Mart Check Cashing Ctr, Inc. v. Epicycle Corp., 667 P.2d 1372 (Colo. 1983).

Refusal to investigate. The protection afforded a holder in due course cannot be used to shield one who simply refuses to investigate when the facts known to him suggest an irregularity concerning the commercial paper he purchases. Salter v. Vanotti, 42 Colo. App. 448, 599 P.2d 962 (1979).

Patient gave sufficient notice to physician of defective character of product and such notice "came to the attention" of the physician, within the meaning of subsection (26), when patient presented herself to the physician in a life-threatening condition. Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984).

Facts not sufficient to constitute notice. The fact that the documents given to subsequent holder referred to a "Deed of Trust" rather than a "Land Sales Agreement" did not give such holder reason to know that the transaction may not have been consummated. Therefore, the subsequent holder did not have knowledge of facts that would give him reason to know of the maker's defense under the Truth in Lending Act. Merchants Mortg. & Trust Corp. v. Dawe, 754 P.2d 418 (Colo. App. 1987).

Record supported the trial court's finding that the bank had no notice of any offset against the promissory note where the note was current in its payments at the time of the transfer, the maker of the note made another payment thereon subsequent to the transfer to the bank, and the note itself did not specify any offset against it. First Nat'l. Bank v. Lohman, 827 P.2d 583 (Colo. App. 1992).

4-1-203. Lease distinguished from security interest. (a) Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.

(b) A transaction in the form of a lease creates a security interest if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee, and:

(1) The original term of the lease is equal to or greater than the remaining economic life of the goods;

(2) The lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;

(3) The lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or

(4) The lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.

(c) A transaction in the form of a lease does not create a security interest merely because:

(1) The present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;

(2) The lessee assumes risk of loss of the goods;

(3) The lessee agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs, with respect to the goods;

(4) The lessee has an option to renew the lease or to become the owner of the goods;

(5) The lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed; or

(6) The lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

(d) Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised. Additional consideration is not nominal if:

(1) When the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed; or

(2) When the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed.

(e) The "remaining economic life of the goods" and "reasonably predictable" fair market rent, fair market value, or cost of performing under the lease agreement shall be determined with reference to the facts and circumstances at the time the transaction is entered into.

Source: L. 2006: Entire article R&RE, p. 464, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-201 (37) as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-201(37).

Changes from former law: This Section is substantively identical to those portions of former UCC Section 1-201(37) that distinguished "true" leases from security interests, except that the definition of "present value" formerly embedded in Section 1-201(37) has been placed in UCC Section 1-201(30a).

1. An interest in personal property or fixtures which secures payment or performance of an obligation is a "security interest." See Section 1-201(37). Security interests are sometimes created by transactions in the form of leases. Because it can be difficult to distinguish leases that create security interests from those that do not, this section provides rules that govern the determination of whether a transaction in the form of a lease creates a security interest.

2. One of the reasons it was decided to codify the law with respect to leases was to resolve an issue that created considerable confusion in the courts: what is a lease? The confusion existed, in part, due to the last two sentences of the definition of security interest in the 1978 Official Text of the Act, Section 1-201(37). The confusion was compounded by the rather considerable change in the federal, state and local tax laws and accounting rules as they relate to leases of goods. The answer is important because the definition of lease determines not only the rights and remedies of the parties to the lease but also those of third parties. If a transaction creates a lease and not a security interest, the lessee's interest in the goods is limited to its leasehold estate; the residual interest in the goods belongs to the lessor. This has significant implications to the lessee's creditors. "On common law theory, the lessor, since he has not parted with title, is entitled to full protection against the lessee's creditors and trustee in bankruptcy ...." 1 G. Gilmore, *Security Interests in Personal Property* § 3.6, at 76 (1965).

Under pre-UCC chattel security law there was generally no requirement that the lessor file the lease, a financing statement, or the like, to enforce the lease agreement against the lessee or any third party; the Article on Secured Transactions (Article 9) did not change the common law in that respect. Coogan, Leasing and the Uniform Commercial Code, in *Equipment Leasing—Leveraged Leasing* 681, 700 n.25, 729 n.80 (2d ed.1980). The Article on Leases (Article 2A) did not change the law in that respect, except for leases of fixtures. Section 2A-309. An examination of the common law will not provide an adequate answer to the question of what is a lease. The definition of security interest in Section 1-201(37) of the 1978 Official Text of the Act provided that the Article on Secured Transactions (Article 9) governs security interests disguised as leases, *i.e.*, leases intended as security; however, the definition became vague and outmoded.

Lease is defined in Article 2A as a transfer of the right to possession and use of goods for a term, in return for consideration. Section 2A-103(1)(j). The definition continues by stating that the retention or creation of a security interest is not a lease. Thus, the task of sharpening the line between true leases and security interests disguised as leases continues to be a function of this Article.

This section begins where Section 1-201(37) leaves off. It draws a sharper line between leases and security interests disguised as leases to create greater certainty in commercial transactions.

Prior to enactment of the rules in this Section, the 1978 text of Section 1-201(37) provided that whether a lease was intended as security (*i.e.*, a security interest disguised as a lease) was to be determined from the facts of each case; however, (a) the inclusion of an option to purchase did not itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee would become, or had the option to become, the owner of the property for no additional consideration, or for a nominal consideration, did make the lease one intended for security.

Reference to the intent of the parties to create a lease or security interest led to unfortunate results. In discovering intent, courts relied upon factors that were thought to be more consistent with sales or loans than leases. Most of these criteria, however, were as applicable to true leases as to security interests. Examples include the typical net lease provisions, a purported lessor's lack of storage facilities or its character as a financing party rather than a dealer in goods. Accordingly, this section contains no reference to the parties' intent.

Subsections (a) and (b) are taken from Section 1(2) of the Uniform Conditional Sales Act (act withdrawn 1943), modified to reflect current leasing practice. Thus, reference to the case law prior to this Act will provide a useful source of precedent. Gilmore, *Security Law, Formalism and Article 9,* 47 Neb.L.Rev. 659, 671 (1968). Whether a transaction creates a lease or a security interest continues to be determined by the facts of each case. Subsection (b) further provides that a transaction creates a security interest

if the lessee has an obligation to continue paying consideration for the term of the lease, if the obligation is not terminable by the lessee (thus correcting early statutory gloss, *e.g., In re Royer's Bakery, Inc.,* 1 U.C.C. Rep.Serv. (Callaghan) 342 (Bankr.E.D.Pa.1963)) and if one of four additional tests is met. The first of these four tests, subparagraph (1), is that the original lease term is equal to or greater than the remaining economic life of the goods. The second of these tests, subparagraph (2), is that the lessee is either bound to renew the lease for the remaining economic life of the goods or to become the owner of the goods. *In re Gehrke Enters.,* 1 Bankr. 647, 651 52 (Bankr.W.D.Wis.1979). The third of these tests, subparagraph (3), is whether the lessee has an option to renew the lease for the remaining economic life or the goods for no additional consideration or for nominal additional consideration, which is defined later in this section. *In re Celeryvale Transp.,* 44 Bankr. 1007, 1014 15 (Bankr.E.D.Tenn.1984). The fourth of these tests, subparagraph (4), is whether the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration. All of these tests focus on economics, not the intent of the parties. *In re Berge,* 32 Bankr. 370, 371 73 (Bankr.W.D.Wis.1983).

The focus on economics is reinforced by subsection (c). It states that a transaction does not create a security interest merely because the transaction has certain characteristics listed therein. Subparagraph (1) has no statutory derivative; it states that a full payout lease does not *per se* create a security interest. *Rushton v. Shea,* 419 F.Supp. 1349, 1365 (D.Del.1976). Subparagraph (2) provides the same regarding the provisions of the typical net lease. *Compare All-States Leasing Co. v. Ochs,* 42 Or.App. 319, 600 P.2d 899 (Ct.App.1979) *with In re Tillery,* 571 F.2d 1361 (5th Cir.1978). Subparagraph (3) restates and expands the provisions of former Section 1-201(37) to make clear that the option can be to buy or renew. Subparagraphs (4) and (5) treat fixed price options and provide that fair market value must be determined at the time the transaction is entered into. *Compare Arnold Mach. Co. v. Balls,* 624 P.2d 678 (Utah 1981) *with Aoki v. Shepherd Mach. Co.,* 665 F.2d 941 (9th Cir.1982).

The relationship of subsection (b) to subsection (c) deserves to be explored. The fixed price purchase option provides a useful example. A fixed price purchase option in a lease does not of itself create a security interest. This is particularly true if the fixed price is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed. A security interest is created only if the option price is nominal and the conditions stated in the introduction to the second paragraph of this subsection are met. There is a set of purchase options whose fixed price is less than fair market value but greater than nominal that must be determined on the facts of each case to ascertain whether the transaction in which the option is included creates a lease or a security interest.

It was possible to provide for various other permutations and combinations with respect to options to purchase and renew. For example, this section could have stated a rule to govern the facts of *In re Marhoefer Packing Co.,* 674 F.2d 1139 (7th Cir.1982). This was not done because it would unnecessarily complicate the definition. Further development of this rule is left to the courts.

Subsections (d) and (e) provide definitions and rules of construction.

ANNOTATION

Annotator's note. Since § 4-1-202 is similar to § 4-1-201 (37) as it existed prior to the 2006 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

A "joint payment agreement" which provides that payments on a contract are to be made jointly to a workman and his supplier is a security agreement which creates a security interest in a contract right. Welbourne Dev. Co. v. Affiliated Clearance Corp., 28 Colo. App. 313, 472 P.2d 684 (1970).

Factors in determining whether a transaction is a lease or sale may include: (1) Whether the lessee is given an option to purchase the equipment, and, if so, whether the option price is nominal; (2) whether the lessee acquires any equity in the equipment; (3) whether the lessee is required to bear the entire risk of the loss; (4) who pays all charges and taxes imposed on ownership; (5) whether there is a provision for acceleration of rental payments; (6) whether the property was purchased specifically for lease to this lessee; and (7) whether the warranties of merchantability and fitness for a particular purpose are specifically excluded by the lease agreement. Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

Characterization of transaction as lease or sale is not conclusive. Whether a transaction is characterized as a lease or sale is not conclusive, but rather it is the intention of the parties that is controlling, that intention to be determined by the facts of each case. Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

Right to reclaim not right to secure payment. The right to reclaim created by § 4-2-507 (2) is a right to undo the transaction, not a right

to "secure" payment of the price as required by the definition of "security interest" under subsection (37) of this section. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Whether a lease is a security interest is applied in In re Mesa Refining, Inc., 52 Bankr. 359 (Bankr. D. Colo. 1985).

4-1-204. Value. Except as otherwise provided in articles 3, 4, and 5 of this title, a person gives value for rights if the person acquires them:

(1) In return for a binding commitment to extend credit or for the extension of immediately available credit, whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection;

(2) As security for, or in total or partial satisfaction of, a preexisting claim;

(3) By accepting delivery under a preexisting contract for purchase; or

(4) In return for any consideration sufficient to support a simple contract.

Source: L. 2006: Entire article R&RE, p. 465, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-201 (44) as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-201(44).

Changes from former law: Unchanged from former Section 1-201, which was derived from Sections 25, 26, 27, 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 58, Uniform Warehouse Receipts Act; Section 22(1), Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. These provisions are substantive rather than purely definitional. Accordingly, they have been relocated from former Section 1-201 to this Section.

1. All the Uniform Acts in the commercial law field (except the Uniform Conditional Sales Act) have carried definitions of "value." All those definitions provided that value was any consideration sufficient to support a simple contract, including the taking of property in satisfaction of or as security for a pre-existing claim. Subsections (1), (2) and (4) in substance continue the definitions of "value" in the earlier acts. Subsection (3) makes explicit that "value" is also given in a third situation: where a buyer by taking delivery under a pre-existing contract converts a contingent into a fixed obligation.

This definition is not applicable to Articles 3 and 4, but the express inclusion of immediately available credit as value follows the separate definitions in those Articles. See Sections 4-208, 4-209, 3-303. A bank or other financing agency which in good faith makes advances against property held as collateral becomes a bona fide purchaser of that property even though provision may be made for charge-back in case of trouble. Checking credit is "immediately available" within the meaning of this section if the bank would be subject to an action for slander of credit in case checks drawn against the credit were dishonored, and when a charge-back is not discretionary with the bank, but may only be made when difficulties in collection arise in connection with the specific transaction involved.

4-1-205. Reasonable time - seasonableness. (a) Whether a time for taking an action required by this title is reasonable depends on the nature, purpose, and circumstances of the action.

(b) An action is taken seasonably if it is taken at or within the time agreed or, if no time is agreed, at or within a reasonable time.

Source: L. 2006: Entire article R&RE, p. 466, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-204 (2) and (3) as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-204(2)-(3).

Changes from former law: This Section is derived from subsections (2) and (3) of former Section 1-204. Subsection (1) of that Section is now incorporated in Section 1-302(b).

1. Subsection (a) makes it clear that requirements that actions be taken within a "reasonable" time are to be applied in the transactional context of the particular action.

2. Under subsection (b), the agreement that fixes the time need not be part of the main agreement, but may occur separately. Notice also that under the definition of "agreement" (Section 1-201) the circumstances of the transaction, including course of dealing or usages of trade or course of performance may be material. On the question what is a reasonable time these matters will often be important.

ANNOTATION

Annotator's note. Since § 4-1-205 is similar to § 4-1-204 as it existed prior to the 2006 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

The question of reasonableness is a question of fact to be measured by all of the circumstances of the case, and pre U.C.C. cases are applicable as they relate to the time for rescission of a contract of sale. Irrigation Motor & Pump Co. v. Belcher, 29 Colo. App. 343, 483 P.2d 980 (1971); Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

Whether notice is given within a reasonable time is a question of fact to be measured by all the circumstances of the case. White v. Mississippi Order Buyers, Inc., 648 P.2d 682 (Colo. App. 1982).

Delivery date not specified. Under either the UCC or common law, where no delivery date is specified, a reasonable date will be furnished by the court. Beiriger and Sons Irrigation, Inc. v. Southwest Land Co., Inc., 705 P.2d 532 (Colo. App. 1985).

Applied in Surplus Electronics Corp. v. Gallin, 653 P.2d 752 (Colo. App. 1982).

PART 3

TERRITORIAL APPLICABILITY AND GENERAL RULES

4-1-301. Territorial applicability - parties' power to choose applicable law. (a) Except as otherwise provided in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties.

(b) In the absence of an agreement effective under subsection (a) of this section, and except as provided in subsection (c) of this section, the "Uniform Commercial Code" applies to transactions bearing an appropriate relation to this state.

(c) If one of the following provisions of the "Uniform Commercial Code" specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law so specified:

(1) Section 4-2-402;
(2) Sections 4-2.5-105 and 4-2.5-106;
(3) Section 4-4-102;
(4) Section 4-4.5-507;
(5) Section 4-5-116;
(6) (Reserved)
(7) Section 4-8-110;
(8) Sections 4-9-301 to 4-9-307.

Source: L. 2006: Entire article R&RE, p. 466, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-105 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-105.

Summary of changes from former law: Section 1-301,which replaces former UCC Section 1-105, represents a significant rethinking of choice of law issues addressed in that section. The new section reexamines both the power of parties to select the jurisdiction whose law will govern their transaction and the determination of the governing law in the absence of such selection by the parties. With respect to the power to select governing law, the draft affords greater party autonomy than former section 1-105, but with important safeguards protecting consumer interests and fundamental policies. While the Drafting Committee considered addressing the related topic of forum selection clauses, it ultimately decided that Article 1 of the Uniform Commercial Code is not an appropriate vehicle for addressing this issue.

Revised UCC section 1-301 addresses contractual designation of governing law somewhat differently than does former section 1-105. Former law allows the parties to any transaction to designate a jurisdiction whose law governs if the transaction bears a "reasonable relation" to that jurisdiction. Revised Article 1 deviates from this unified approach by providing different rules for consumer transactions than for "business to business" transactions.

In the context of consumer transactions, revised Article 1, unlike former law, generally protects consumers against the possibility of losing the protection of consumer protection laws of their home jurisdiction.

In the context of business-to-business transactions, revised Article 1 generally provides the parties with greater autonomy to designate a jurisdiction whose law will govern than does former Article 1, but also provides some safeguards against abuse that do not appear in former Article 1. Following emerging international norms, greater autonomy is provided in subsections (b) and (c) by deleting the requirement that the transaction bear a "reasonable relation" to the jurisdiction designated in this non-consumer context. It should be noted in this regard that in the case of wholly domestic transactions the jurisdiction designated must be a State. An important safeguard not present in former law is provided in subsection (e). Subsection (e) indicates that the designation of a jurisdiction's law is not effective (even if the transaction bears a reasonable relation to that jurisdiction) to the extent that application of that law would be contrary to a fundamental policy of the jurisdiction whose law would govern in the absence of contractual designation. Application of the law designated may be contrary to a fundamental policy of the State or country whose law would otherwise govern either because of the nature of the law designated or because of the "mandatory" nature of the law that would otherwise apply.

In the absence of an effective contractual designation of governing law, former UCC section 1-105(1) directs the forum to apply its own law if the transaction bears "an appropriate relation to this state." This provision, however, is frequently ignored by courts. Revised UCC section 1-301(c) provides simply that, in the absence of contractual designation, the court should apply the forum's choice of law principles.

1. *Applicability of section.* This section is neither a full Restatement of choice of law principles nor a free-standing choice of law statute. Rather, it is a provision of Article 1 of the Uniform Commercial Code. As such, it is subject to Section 1-102, which states the scope of Article 1. As that section indicates, Article 1, and the rules contained therein, apply to transactions to the extent that they are governed by one of the other Articles of the Uniform Commercial Code. Thus, this section does not apply to a transaction outside the scope of the Uniform Commercial Code such as a services contract or a contract for the sale of real estate. On the other hand, if the transaction is within the scope of a substantive Article of the Uniform Commercial Code, such as in the case of a sale or lease of goods, this section does apply.

In some cases, a transaction is neither completely within the scope of the Uniform Commercial Code (as in the case of a sale or lease of goods) nor completely outside the scope of the Uniform Commercial Code (as in the case of a contract for the sale of real estate). Rather, some aspects of the transaction are within the substantive scope of the Uniform Commercial Code while other aspects are not. One example of this phenomenon is an agreement to loan money in which the borrower's obligation to repay the loan is secured by a security interest in personal property. The security agreement, and the security interest created thereby, are clearly within the scope of Article 9. The loan agreement, on the other hand, is governed not by the Uniform Commercial Code but by the general law of contracts. Another example is provided by a real estate lease in which the lessee's obligation to pay the stated rent is backed by a standby letter of credit issued by a bank. The lease is governed by realty law outside the Uniform Commercial Code, while the letter of credit is governed by Article 5. While this section, by its terms, only applies to the UCC aspect of such a "mixed transaction," it is within a court's discretion to decide in a particular case that bifurcation of the choice of law principles applicable to the transaction is inadvisable and, accordingly, to apply principles of this section to the non-UCC aspects of the transaction in order to have the law

of the same State or country apply to the entire transaction. When the UCC aspects of such a "mixed transaction" predominate, such a decision may be particularly appropriate.

2. *Contractual choice of law.* This section allows parties broad autonomy, with several important limitations, to select the law governing their transaction, even if the transaction does not bear a relation to the State or country whose law is selected. This recognition of party autonomy with respect to governing law has already been established in several Articles of the Uniform Commercial Code (see UCC Sections 4A-507, 5-116, and 8-110) and is consistent with international norms. See, e.g., Inter-American Convention on the Law Applicable to International Contracts, Article 7 (Mexico City 1994); Convention on the Law Applicable to Contracts for the International Sale of Goods, Article 7(1) (The Hague 1986); EC Convention on the Law Applicable to Contractual Obligations, Article 3(1) (Rome 1980).

There are three important limitations on this party autonomy to select governing law. First, a different, and more protective, rule applies in the context of consumer transactions (see note c). Second, in an entirely domestic transaction, this section does not validate the selection of foreign law. (See note d.) Third, contractual choice of law will not be given effect to the extent that application of the law designated would be contrary to a fundamental policy of the State or country whose law would be applied in the absence of such contractual designation (see Comment 5).

The Drafting Committee considered whether this Section should expressly provide for the ability of parties to designate non-legal codes such as trade codes as the set of rules governing their transaction, but decided that the principles of Section 1-302 allowing parties broad freedom of contract to structure their relation are adequate for this purpose. A similar decision was made with respect to the ability of the parties to designate recognized bodies of rules or principles applicable to commercial transactions that are promulgated by intergovernmental authorities such as UNCITRAL or UNIDROIT. See, e.g., UNIDROIT Principles of International Commercial Contracts.

3. *Consumer transactions.* If one of the parties is a consumer (as defined in section 1-201(11a)), subsection (d) provides the parties less autonomy to designate the State or country whose law will govern. First, in a consumer transaction subsection (d)(1) provides that the transaction must bear a reasonable relation to the State or country designated. Second, except as noted below, subsection (d)(2) provides that a designation of the law of a State or country other than that of the consumer's habitual residence, even if the transaction bears a reasonable relation to that State or country, will not deprive the consumer of the protection of any rules of law of the consumer's habitual residence which are protective of consumers and are not variable by agreement. (It should be noted that the phrase "rule of law" is intended to refer to case law as well as statutes and administrative regulations.) Thus, for example, in the case of a sale of goods by a seller in Indiana to a consumer buyer in New York, in which transaction the contract designates Indiana law as governing, the New York buyer will retain the protection of non-waivable New York rules of law that are protective of consumers.

There is one exception to this principle. In the case of a sale of goods to a consumer in which the consumer makes the contract and takes possession of the goods in a State or country other than the consumer's habitual residence, subsection (d)(2)(B) provides that it is the consumer protection rules of law of that State or country that cannot be eliminated by choice of law. Thus, for example, if a New York consumer, while on vacation in Indiana, buys goods and takes delivery of them at an Indiana branch of an Ohio retailer, and the contract designates Ohio law as governing, this choice of law may not deprive the New York consumer buyer of non-waivable Indiana rules of law that are protective of consumers, but may deprive that buyer of analogous New York rules. This exception, adapted from UCC section 2A-106 and Article 5 of the EC Convention on the Law Applicable to Contractual Obligations, enables a seller that engages in only face-to-face transactions to ascertain in advance which consumer protection law it is subject to. The reference in subsection (d)(2)(B) to the State or country in which the consumer makes the contract should not be read to incorporate formalistic concepts of where the last event necessary to conclude the contract took place; rather, the intent is to identify the state in which all material steps were taken by the consumer to enter into the contract.

In the absence of a contractual designation of governing law, application of the choice of law rules of the forum, as mandated by subsection (c), could lead to application of the laws of a State or country other than that of the consumer's habitual residence. In such a case, subsection (d)(2) still applies to preserve consumer protection rules for the benefit of the consumer as described in the preceding paragraph.

4. *Wholly domestic transactions.* While this Section provides parties broad autonomy to select governing law, that autonomy is limited in the case of wholly domestic transactions. In a "domestic transaction," subsection (b)(1) validates only the designation of the law of a State. A "domestic transaction" is a transaction that does not bear a reasonable relation to a country other than the United States. See subsection (a). Thus, in a wholly domestic non-consumer transaction, parties may (subject to the limitations set

out in subsections (e) and (f)) designate the law of any State but not the law of a foreign country.

5. *International transactions.* This section provides greater autonomy in the context of international transactions. As defined in subsection (a)(2), a transaction is an "international transaction" if it bears a reasonable relation to a country other than the United States. In a non-consumer international transaction, subsection (b)(2) provides that a designation of the law of any State or country is effective (subject, of course, to the limitations set out in subsections (e) and (f)). It is important to note that the transaction need not bear a relation to the State or country designated so long as the transaction is international. Thus, for example, in a non-consumer lease of goods in which the lessor is located in Mexico and the lessee is located in Louisiana, a designation of the law of Ireland to govern the transaction would be given effect under this section even though the transaction may bear no relation to Ireland. The ability to designate the law of any country in non-consumer international transactions is important in light of the common practice in many commercial contexts of designating the law of a "neutral" jurisdiction whose law is well-developed.

6. *Fundamental policy.* Subsection (e) provides that an agreement designating the governing law will not be given effect to the extent that application of the designated law would be contrary to a fundamental policy of the State or country whose law would otherwise govern. This rule provides a narrow exception to the broad autonomy afforded to parties in subsection (b). One of the prime objectives of contract law is to protect the justified expectations of the parties and to make it possible for them to foretell with accuracy what will be their rights and liabilities under the contract. In this way, certainty and predictability of result are most likely to be secured. See Restatement (Second) Conflict of Laws, § 187, comment *e*.

Under the fundamental policy doctrine, a court should not refrain from applying the designated law merely because this would lead to a result different than would be obtained under the local law of the State or country whose law would otherwise govern. Rather, the difference must be contrary to a public policy that is so substantial that it justifies overriding the concerns for certainty and predictability underlying modern commercial law as well as concerns for judicial economy generally. Thus, application of the designated law will rarely be found to be contrary to a fundamental policy of the State or country whose law would otherwise govern when the difference between the two concerns a requirement, such as a statute of frauds, that relates to formalities, or general rules of contract law, such as those concerned with the need for consideration.

The opinion of Judge Cardozo in *Loucks v. Standard Oil Co. of New York*, 120 N.E. 198 (1918), regarding the related issue of when a state court may decline to apply the law of another state, is a helpful touchstone here:

Our own scheme of legislation may be different. We may even have no legislation on the subject. That is not enough to show that public policy forbids us to enforce the foreign right. A right of action is property. If a foreign statute gives the right, the mere fact that we do not give a like right is no reason for refusing to help the plaintiff in getting what belongs to him. We are not so provincial as to say that every solution of a problem is wrong because we deal with it otherwise at home. Similarity of legislation has indeed this importance; its presence shows beyond question that the foreign statute does not offend the local policy. But its absence does not prove the contrary. It is not to be exalted into an indispensable condition. The misleading word 'comity' has been responsible for much of the trouble. It has been fertile in suggesting a discretion unregulated by general principles.

* * *

The courts are not free to refuse to enforce a foreign right at the pleasure of the judges, to suit the individual notion of expediency or fairness. They do not close their doors, unless help would violate some fundamental principle of justice, some prevalent conception of good morals, some deep-rooted tradition of the common weal. 120 N.E. at 201-02 (citations to authorities omitted).

Analytically, one might conclude that application of the designated law is contrary to a fundamental policy of the State or country whose law would otherwise govern either (i) because the substance of the designated law violates a fundamental principle of justice of that State or country or (ii) because it differs from a rule of that State or country that is "mandatory" in that it *must* be applied in the courts of that State or country without regard to otherwise-applicable choice of law rules of that State or country and without regard to whether the designated law is otherwise offensive. This distinction, which may have more theoretical than practical significance, has been suggested in some international conventions in this area, although in some cases the concept is applied to authorize the *forum* state to apply *its* mandatory rules, rather than those of the State or country whose law would otherwise govern. The latter situation is not addressed by this section. See comment 9.

In any event, it is obvious that a rule that is freely changeable by agreement of the parties under the law of the State or country whose law would otherwise govern can hardly be construed as a mandatory rule of that State or country. This does not mean, however, that rules that cannot

be changed by agreement under that law are, for that reason alone, mandatory rules. Otherwise, contractual choice of law in the UCC context would be illusory and redundant; the parties would be able to accomplish by choice of law no more than can be accomplished under Section 1-302 (by agreeing to vary the rules that would otherwise govern their transaction by substituting for those rules the rules that would apply if the transaction were governed by the designated State or country) without designation of governing law. Indeed, other than cases in which a mandatory choice of law rule is established by statute (see, e.g., UCC sections 9-301 through 9-307, explicitly preserved in subsection (f)), cases in which courts have declined to follow the designated law solely because a rule of the State or country whose law would otherwise govern is mandatory are rare.

7. *Choice of law in the absence of contractual designation.* Subsection (c), which replaces the second sentence of former UCC Section 1-105(1), determines which jurisdiction's law governs a transaction in the absence of an effective contractual choice by the parties. Former Section 1-105(1), provided that the law of the forum (*i.e.,* the Uniform Commercial Code) applies if the transaction bears "an appropriate relation to this state." By using an "appropriate relation" test, rather than, say, requiring that the forum be the location of the "most significant" contact, Section 1-105(1) expressed a bias in favor of applying the forum's law. This bias, while not universally respected by the courts, was justifiable in light of the uncertainty that existed at the time of drafting as to whether the Uniform Commercial Code would be adopted by all the states; the pro-forum bias would assure that the Uniform Commercial Code would be applied so long as the transaction bore an "appropriate" relation to the forum. Inasmuch as the Uniform Commercial Code has been adopted, at least in part, in all U.S. jurisdictions, the vitality of this point is minimal in the domestic context, and international comity concerns militate against continuing the pro-forum, pro-UCC bias in transnational transactions. When the choice is between the law of two jurisdictions that have adopted the Uniform Commercial Code, but whose law differs (whether because of differences in enacted language or differing judicial interpretations), there is no strong justification for directing a court to apply different choice of law rules to its determination than it would apply if the matter were not governed by the Uniform Commercial Code. Similarly, given the wide variety of choice of law principles applied by the states, it would not be prudent to designate only one such principle as the proper one for transactions governed by the Uniform Commercial Code. Accordingly, in cases in which the parties have not made an effective choice of law, Section 1-301(a) simply directs the forum to apply its ordinary choice of law principles to determine which jurisdiction's law governs.

8. *Primacy of other UCC choice of law rules.* Subsection (f), which is essentially identical to former UCC Section 1-105(2), indicates that choice of law rules provided in the other Articles govern when applicable.

9. *Matters not addressed by this section.* As noted in comment 1, this section is not a complete statement of conflict of laws doctrines applicable in commercial cases. In particular, this section does not address, and leaves to other law, two issues that relate to the forum and its law. First, a forum will occasionally decline to apply the law of a different jurisdiction selected by the parties when application of that law would be contrary to a fundamental policy of the forum jurisdiction, even if it would not be contrary to a fundamental policy of the State or country whose law would govern in the absence of contractual designation. Standards for application of this doctrine relate primarily to concepts of sovereignty rather than commercial law and are thus left to the courts. Second, in determining whether to give effect to the parties' agreement that the law of a particular State or country will govern their relationship, courts must, of necessity, address some issues as to the basic validity of that agreement. These issues might relate, for example, to capacity to contract and absence of duress. This section does not address these issues.

4-1-302. Variation by agreement. (a) Except as otherwise provided in subsection (b) of this section or elsewhere in this title, the effect of provisions of this title may be varied by agreement.

(b) The obligations of good faith, diligence, reasonableness, and care prescribed by this title may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever this title requires any action to be taken within a reasonable time, any time that is not manifestly unreasonable may be fixed by agreement.

(c) The presence in certain provisions of this title of the phrase "unless otherwise agreed", or words of similar import, does not imply that the effect of other provisions may not be varied by agreement under this section.

Source: L. 2006: Entire article R&RE, p. 466, § 1, effective September 1.

Editor's note: This section is similar to former §§ 4-1-102 (3) and (4) and 4-1-204 (1) as they existed prior to 2006.

OFFICIAL COMMENT

Source: Former Sections 1-102(3)-(4) and 1-204(1).

Changes: This section combines the rules from subsections (3) and (4) of former Section 1-102 and subsection (1) of former Section 1-204. No substantive changes are made.

1. Subsection (a) states affirmatively at the outset that freedom of contract is a principle of the Uniform Commercial Code: "the effect" of its provisions may be varied by "agreement." The meaning of the statute itself must be found in its text, including its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement. But the Uniform Commercial Code seeks to avoid the type of interference with evolutionary growth found in pre-Code cases such as Manhattan Co. v. Morgan, 242 N.Y. 38, 150 N.E. 594 (1926). Thus private parties cannot make an instrument negotiable within the meaning of Article 3 except as provided in Section 3-104; nor can they change the meaning of such terms as "bona fide purchaser," "holder in due course," or "due negotiation," as used in the Uniform Commercial Code. But an agreement can change the legal consequences that would otherwise flow from the provisions of the Uniform Commercial Code. "Agreement" here includes the effect given to course of dealing, usage of trade and course of performance by Sections 1-201 and 1-303; the effect of an agreement on the rights of third parties is left to specific provisions of the Uniform Commercial Code and to supplementary principles applicable under Section 1-103. The rights of third parties under Section 9-317 when a security interest is unperfected, for example, cannot be destroyed by a clause in the security agreement.

This principle of freedom of contract is subject to specific exceptions found elsewhere in the Uniform Commercial Code and to the general exception stated here. The specific exceptions vary in explicitness: the statute of frauds found in Section 2-201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies enforcement to such a waiver as part of the "contract" made unenforceable; Section 9-602, on the other hand, is a quite explicit limitation on freedom of contract. Under the exception for "the obligations of good faith, diligence, reasonableness and care prescribed by [the Uniform Commercial Code]," provisions of the Uniform Commercial Code prescribing such obligations are not to be disclaimed. However, the section also recognizes the prevailing practice of having agreements set forth standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are unreasonable, the agreement controls. In this connection, Section 1-303 incorporating into the agreement prior course of dealing and usages of trade is of particular importance.

Subsection (b) also recognizes that nothing is stronger evidence of a reasonable time than the fixing of such time by a fair agreement between the parties. However, provision is made for disregarding a clause which whether by inadvertence or overreaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not obviously unfair as judged by the time of contracting.

2. An agreement that varies the effect of provisions of the Uniform Commercial Code may do so by stating the rules that will govern in lieu of the provisions varied. Alternatively, the parties may vary the effect of such provisions by stating that their relationship will be governed by recognized bodies of rules or principles applicable to commercial transactions. Such bodies of rules or principles may include, for example, those that are promulgated by intergovernmental authorities such as UNCITRAL or UNIDROIT (see, e.g., UNIDROIT Principles of International Commercial Contracts), or non-legal codes such as trade codes.

3. Subsection (c) is intended to make it clear that, as a matter of drafting, phrases such as "unless otherwise agreed" have been used to avoid controversy as to whether the subject matter of a particular section does or does not fall within the exceptions to subsection (b), but absence of such words contains no negative implication since under subsection (b) the general and residual rule is that the effect of all provisions of the Uniform Commercial Code may be varied by agreement.

4-1-303. Course of performance, course of dealing, and usage of trade. (a) A "course of performance" is a sequence of conduct between the parties to a particular transaction that exists if:

(1) The agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and

(2) The other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.

(b) A "course of dealing" is a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(c) A "usage of trade" is any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law.

(d) A course of performance or course of dealing between the parties, or usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware, is relevant in ascertaining the meaning of the parties' agreement, may give particular meaning to specific terms of the agreement, and may supplement or qualify the terms of the agreement. A usage of trade applicable in the place in which part of the performance under the agreement is to occur may be so utilized as to that part of the performance.

(e) Except as otherwise provided in subsection (f) of this section, the express terms of an agreement and any applicable course of performance, course of dealing, or usage of trade shall be construed whenever reasonable as consistent with each other. If such a construction is unreasonable:

(1) Express terms prevail over course of performance, course of dealing, and usage of trade;

(2) Course of performance prevails over course of dealing and usage of trade; and

(3) Course of dealing prevails over usage of trade.

(f) Subject to section 4-2-209, a course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

(g) Evidence of a relevant usage of trade offered by one party is not admissible unless that party has given the other party notice that the court finds sufficient to prevent unfair surprise to the other party.

Source: L. 2006: Entire article R&RE, p. 467, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-205 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Sections 1-205, 2-208, and Section 2A-207.

Changes from former law: This section integrates the "course of performance" concept from Articles 2 and 2A into the principles of former Section 1-205, which deals with course of dealing and usage of trade. In so doing, the section slightly modifies the articulation of the course of performance rules to fit more comfortably with the approach and structure of former UCC Section 1-205. There are also slight modifications to be more consistent with the definition of "agreement" in former section 1-201(3). It should be noted that a course of performance that might otherwise establish a defense to the obligation of a party to a negotiable instrument is not available as a defense against a holder in due course who took the instrument without notice of that course of performance.

1. The Uniform Commercial Code rejects both the "lay-dictionary" and the "conveyancer's" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

2. "Course of dealing," as defined in subsection (b), is restricted, literally, to a sequence of conduct between the parties previous to the agreement. A sequence of conduct after or under the agreement, however, is a "course of performance." "Course of dealing" may enter the agreement either by explicit provisions of the agreement or by tacit recognition.

3. The Uniform Commercial Code deals with "usage of trade" as a factor in reaching the commercial meaning of the agreement that the parties have made. The language used is to be

interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. By adopting in this context the term "usage of trade," the Uniform Commercial Code expresses its intent to reject those cases which see evidence of "custom" as representing an effort to displace or negate "established rules of law." A distinction is to be drawn between mandatory rules of law such as the Statute of Frauds provisions of Article 2 on Sales whose very office is to control and restrict the actions of the parties, and which cannot be abrogated by agreement, or by a usage of trade, and those rules of law (such as those in Part 3 of Article 2 on Sales) which fill in points which the parties have not considered and in fact agreed upon. The latter rules hold "unless otherwise agreed" but yield to the contrary agreement of the parties. Part of the agreement of the parties to which such rules yield is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding.

4. A usage of trade under subsection (c) must have the "regularity of observance" specified. The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial," "universal," or the like. Under the requirement of subsection (c) full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree. There is room also for proper recognition of usage agreed upon by merchants in trade codes.

5. The policies of the Uniform Commercial Code controlling explicit unconscionable contracts and clauses (Sections 1-304, 2-302) apply to implicit clauses that rest on usage of trade and carry forward the policy underlying the ancient requirement that a custom or usage must be "reasonable." However, the emphasis is shifted. The very fact of commercial acceptance makes out a *prima facie* case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable. But the anciently established policing of usage by the courts is continued to the extent necessary to cope with the situation arising if an unconscionable or dishonest practice should become standard.

6. Subsection (d), giving the prescribed effect to usages of which the parties "are or should be aware," reinforces the provision of subsection (c) requiring not universality but only the described "regularity of observance" of the practice or method. This subsection also reinforces the point of subsection (c) that such usages may be either general to trade or particular to a special branch of trade.

7. Although the definition of "agreement" in Section 1-201 includes the elements of course of performance, course of dealing, and usage of trade, the fact that express reference is made in some sections to those elements is not to be construed as carrying a contrary intent or implication elsewhere. Compare Section 1-302(c).

8. In cases of a well established line of usage varying from the general rules of the Uniform Commercial Code where the precise amount of the variation has not been worked out into a single standard, the party relying on the usage is entitled, in any event, to the minimum variation demonstrated. The whole is not to be disregarded because no particular line of detail has been established. In case a dominant pattern has been fairly evidenced, the party relying on the usage is entitled under this section to go to the trier of fact on the question of whether such dominant pattern has been incorporated into the agreement.

9. Subsection (g) is intended to insure that this Act's liberal recognition of the needs of commerce in regard to usage of trade shall not be made into an instrument of abuse.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Annotator's note. Since § 4-1-303 is similar to § 4-1-205 as it existed prior to the 2006 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Previous course of dealing considered in determining meaning of contract provisions. It is the policy of the uniform commercial code to consider previous course of dealing in determining the meaning of contract provisions. Amerine Nat'l Corp. v. Denver Feed Co., 493 F.2d 1275 (10th Cir. 1974); Great W. Sugar Co. v. Northern Natural Gas Co., 661 P.2d 684 (Colo. App. 1982), aff'd sub nom. KN Energy, Inc. v. Great Western Sugar Co., 698 P.2d 769 (Colo. 1985), cert. denied, 472 U.S. 1022, 105 S. Ct. 3489, 87 L. Ed.2d 623 (1985).

Test of admissibility of evidence of prior course of dealing is not whether the contract appears to be complete in every detail, but whether the proffered evidence of course of dealing reasonably can be construed as consistent with the express terms of the agreement; if this evidence contradicts or negates the terms of

a written agreement, it is inadmissible. Budget Sys. v. Seifert Pontiac, Inc., 40 Colo. App. 406, 579 P.2d 87 (1978).

Evidence of course of dealing and course of performance is admissible if it does not directly contradict the terms of a written agreement, but merely explains or supplements it. Great W. Sugar Co. v. Northern Natural Gas Co., 661 P.2d 684 (Colo. App. 1982), aff'd sub nom. KN Energy, Inc. v. Great Western Sugar Co., 698 P.2d 769 (Colo. 1985), cert. denied, 472 U.S. 1022, 105 S. Ct. 3489, 87 L. Ed.2d 623 (1985).

Course of dealing not purchased with business. Absent evidence to the contrary, the purchaser of a business does not automatically adopt the seller's prior course of dealing with third parties. Budget Sys. v. Seifert Pontiac, Inc., 40 Colo. App. 406, 579 P.2d 87 (1978).

The provisions of a security agreement may be supplemented by the "usage of trade", provided the express terms of the agreement and the supplement are consistent with each other. Colo. Bank & Trust Co. v. Western Slope Invs., Inc., 36 Colo. App. 149, 539 P.2d 501 (1975).

Absent express or otherwise demonstrated authorization for borrower's conduct, the UCC mandates that the express terms of the agreement are controlling. U.S. v. Winter Livestock Comm'n, 924 F. 2d 986 (10th Cir. 1991).

Terms of agreement control. Even assuming that a loan officer's testimony showed a "usage of trade", where that usage would not be consistent with the terms of the security agreement, the express terms of the agreement control. Colo. Bank & Trust Co. v. Western Slope Invs., Inc., 36 Colo. App. 149, 539 P.2d 501 (1975).

Course of dealing supported interest charge. Murray Equipment Co. v. Curtis, Inc., 725 P.2d 35 (Colo. App. 1986).

Course of dealing did not support interest charge. Winer's Pumping Units v. Emerald Gas Operating Co., 936 P.2d 627 (Colo. App. 1997).

Applied in Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976).

4-1-304. Obligation of good faith. Every contract or duty within this title imposes an obligation of good faith in its performance and enforcement.

Source: L. 2006: Entire article R&RE, p. 468, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-203 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-203.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this Section is identical to former UCC Section 1-203. A comment will make it clear that this section applies to the exercise of rights granted by the Uniform Commercial Code.

1. This section sets forth a basic principle running throughout the Uniform Commercial Code. The principle is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. While this duty is explicitly stated in some provisions of the Uniform Commercial Code, the applicability of the duty is broader than merely these situations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this Act. It is further implemented by Section 1-303 on course of dealing, course of performance, and usage of trade. This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.

2. "Performance and enforcement" of contracts and duties within the Uniform Commercial Code include the exercise of rights created by the Uniform Commercial Code.

ANNOTATION

Annotator's note. Since § 4-1-304 is similar to § 4-1-203 as it existed prior to the 2006 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Notwithstanding a provision precluding

implied covenants, all contracts contain an implied duty of good faith and fair dealing. Amoco Oil Co. v. Ervin, 908 P.2d 493 (Colo. 1995); Transamerica Premier Ins. Co. v. Brighton Sch. Dist. 27J, 940 P.2d 348 (Colo. 1997).

Financial statement not listing partners as debtors does not violate good faith. A financial statement which does not list the partners as debtors, but only sets forth the partnership name, does not violate the obligation of good faith required by this section. Bd. of County Comm'rs v. Berkeley Vill., 40 Colo. App. 431, 580 P.2d 1251 (1978).

Implied covenant of good faith and fair dealing found in some commercial contracts held not to extend to employment contracts. Pittman v. Larson Distributing Co., 724 P.2d 1379 (Colo. App. 1986).

Applied in MacGregor v. McReki, Inc., 30 Colo. App. 196, 494 P.2d 1297 (1971); Layne v. Fort Carson Nat'l Bank, 655 P.2d 856 (Colo. App. 1982); ADT Sec. Servs. v. Premier Home Prot., 181 P.3d 288 (Colo. App. 2007).

4-1-305. Remedies to be liberally administered. (a) The remedies provided by this title must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special damages nor penal damages may be had except as specifically provided in this title or by other rule of law.

(b) Any right or obligation declared by this title is enforceable by action unless the provision declaring it specifies a different and limited effect.

Source: L. 2006: Entire article R&RE, p. 468, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-106 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-106.

Changes from former law: Other than changes in the form of reference to the Uniform Commercial Code, this section is identical to former UCC Section 1-106.

1. Subsection (a) is intended to effect three propositions. The first is to negate the possibility of unduly narrow or technical interpretation of remedial provisions by providing that the remedies in the Uniform Commercial Code are to be liberally administered to the end stated in this section. The second is to make it clear that compensatory damages are limited to compensation. They do not include consequential or special damages, or penal damages; and the Uniform Commercial Code elsewhere makes it clear that damages must be minimized. Cf. Sections 1-203, 2-706(1), and 2-712(2). The third purpose of subsection (a) is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more. Cf. Section 2-204(3).

2. Under subsection (b), any right or obligation described in the Uniform Commercial Code is enforceable by action, even though no remedy may be expressly provided, unless a particular provision specifies a different and limited effect. Whether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. Sections 1-103, 2-716.

3. "Consequential" or "special" damages and "penal" damages are not defined in the Uniform Commercial Code; rather, these terms are used in the sense in which they are used outside the Uniform Commercial Code.

ANNOTATION

Law reviews. For article, "An Introduction to the Economic Analysis of Contract Remedies", see 57 U. Colo. L. Rev. 683 (1986).

Annotator's note. Since § 4-1-305 is similar to § 4-1-106 as it existed prior to the 2006 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Damages need not be exactly calculable. Although damages may not be calculable with mathematical exactitude, so long as the plaintiff introduces some evidence which is sufficient to allow a reasonable estimate of damages, it is incumbent upon the trier of fact to determine a monetary award which will adequately compensate the plaintiff. Great W. Food Packers, Inc. v.

Longmont Foods Co., 636 P.2d 1331 (Colo. App. 1981).

Damages need not be allocatable where defendant manufactures number of defective products. Where a plaintiff's total damages can be ascertained and they stem from a number of defective products manufactured by the same defendant, it is not necessary to allocate damages among specific items. Great W. Food Packers, Inc. v. Longmont Foods Co., 636 P.2d 1331 (Colo. App. 1981).

Where award of replacement cost of defective part insufficient. Where there is a "latent defect" which cannot be corrected simply by replacing a defective part and awarding the costs of replacing that part would not make the aggrieved party whole, an award of the entire value of the product damages is appropriate. Gibbons v. Windish, Inc., 662 P.2d 500 (Colo. App. 1983).

4-1-306. Waiver or renunciation of claim or right after breach. A claim or right arising out of an alleged breach may be discharged in whole or in part without consideration by agreement of the aggrieved party in an authenticated record.

Source: L. 2006: Entire article R&RE, p. 468, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-107 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-107.

Changes from former law: This section changes former law in two respects. First, former Section 1-107, requiring the "delivery" of a "written waiver or renunciation" merges the separate concepts of the aggrieved party's agreement to forego rights and the manifestation of that agreement. This section separates those concepts, and explicitly requires *agreement* of the aggrieved party. Second, the revised section reflects developments in electronic commerce by providing for memorialization in an authenticated record.

1. This section makes consideration unnecessary to the effective renunciation or waiver of rights or claims arising out of an alleged breach of a commercial contract where the agreement effecting such renunciation is memorialized in a record authenticated by the aggrieved party. Its provisions, however, must be read in conjunction with the section imposing an obligation of good faith. (Section 1-304).

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Loan Documentation Clauses to Avoid Lender Liability", 19 Colo. Law. 2225 (1990).

Annotator's note. Since § 4-1-306 is similar to § 4-1-107 as it existed prior to the 2006 repeal and reenactment of this article, a relevant case construing that provision has been included in the annotations to this section.

Payors were not "aggrieved parties", and thus could not relieve themselves of their obligations under notes by notifying bank that they waived their signatures. Farmers and Stockmens Bank v. Stafford, 738 P.2d 60 (Colo. App. 1987).

4-1-307. Prima facie evidence by third-party documents. A document in due form purporting to be a bill of lading, policy or certificate of insurance, official weigher's or inspector's certificate, consular invoice, or any other document authorized or required by the contract to be issued by a third party shall be prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party.

Source: L. 2006: Entire article R&RE, p. 468, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-202 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-202.

Changes from former law: No changes.

1. This section supplies judicial recognition for documents that are relied upon as trustworthy by commercial parties.

2. This section is concerned only with documents that have been given a preferred status by the parties themselves who have required their procurement in the agreement, and for this reason the applicability of the section is limited to actions arising out of the contract that authorized or required the document. The list of documents is intended to be illustrative and not exclusive.

3. The provisions of this section go no further than establishing the documents in question as prima facie evidence and leave to the court the ultimate determination of the facts where the accuracy or authenticity of the documents is questioned. In this connection the section calls for a commercially reasonable interpretation.

4. Documents governed by this section need not be writings if records in another medium are generally relied upon in the context.

4-1-308. Performance or acceptance under reservation of rights. (a) A party that with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice", "under protest", or the like are sufficient.

(b) Subsection (a) of this section does not apply to an accord and satisfaction.

Source: L. 2006: Entire article R&RE, p. 468, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-207 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-207.

Changes from former law: This section is identical to former UCC Section 1-207.

1. This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights," and the like. All of these phrases completely reserve all rights within the meaning of this section. The section therefore contemplates that limited as well as general reservations and acceptance by a party may be made "subject to satisfaction of our purchaser," "subject to acceptance by our customers," or the like.

2. This section does not add any new requirement of language of reservation where not already required by law, but merely provides a specific measure on which a party can rely as that party makes or concurs in any interim adjustment in the course of performance. It does not affect or impair the provisions of this Act such as those under which the buyer's remedies for defect survive acceptance without being expressly claimed if notice of the defects is given within a reasonable time. Nor does it disturb the policy of those cases which restrict the effect of a waiver of a defect to reasonable limits under the circumstances, even though no such reservation is expressed.

The section is not addressed to the creation or loss of remedies in the ordinary course of performance but rather to a method of procedure where one party is claiming as of right something which the other believes to be unwarranted.

3. Subsection (b) states that this section does not apply to an accord and satisfaction. Section 3-311 governs if an accord and satisfaction is attempted by tender of a negotiable instrument as stated in that section. If Section 3-311 does not apply, the issue of whether an accord and satisfaction has been effected is determined by the law of contract. Whether or not Section 3-311 applies, this section has no application to an accord and satisfaction.

ANNOTATION

Law reviews. For article, "UCC Section 1-207 on 'Full Payment' Checks: Lawyers Beware", see 11 Colo. Law. 2584 (1982).

Annotator's note. Since § 4-1-308 is similar to § 4-1-207 as it existed prior to the 2006 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

This section does not alter the law of accord and satisfaction. If a check is tendered as

full satisfaction of an obligation, acceptance and negotiation of the check by the obligee discharges the underlying obligation notwithstanding a restrictive endorsement made by the obligee. R.A. Reither Const. Co. v. Wheatland Rural Elec. Ass'n, 680 P.2d 1342 (Colo. App. 1984); Anderson v. Rosebrook, 737 P.2d 417 (Colo. 1987).

Plaintiff landowner who promised performance "under protest" by letter from his attorney to the defendants and then later discharged a note and deed of trust without protest at closing, did not relinquish his rights having complied with the plain language of this section by protesting before performance. Margason v. Roberts, 919 P.2d 818 (Colo. App. 1995).

As plaintiff was not required to renew his protest at closing, so any reliance defendants placed on plaintiff's silence was unreasonable. Margason v. Roberts, 919 P.2d 818 (Colo. App. 1995).

4-1-309. Option to accelerate at will. A term providing that one party or that party's successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or when the party "deems itself insecure", or words of similar import, means that the party has power to do so only if that party in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against which the power has been exercised.

Source: L. 2006: Entire article R&RE, p. 469, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-208 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-208.

Changes from former law: Except for minor stylistic changes, this section is identical to former UCC Section 1-208.

1. The common use of acceleration clauses in many transactions governed by the Uniform Commercial Code, including sales of goods on credit, notes payable at a definite time, and secured transactions, raises an issue as to the effect to be given to a clause that seemingly grants the power to accelerate at the whim and caprice of one party. This section is intended to make clear that despite language that might be so construed and which further might be held to make the agreement void as against public policy or to make the contract illusory or too indefinite for enforcement, the option is to be exercised only in the good faith belief that the prospect of payment or performance is impaired.

Obviously this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an obligation of payment or performance which in the first instance is due at a future date.

ANNOTATION

Law reviews. For article, "Setoff and Security Interests In Deposit Accounts", see 17 Colo. Law. 2107 (1988).

Annotator's note. Since § 4-1-309 is similar to § 4-1-208 as it existed prior to the 2006 repeal and reenactment of this article, a relevant case construing that provision has been included in the annotations to this section.

Objective test, rather than subjective test, should be applied to determine proper invocation of insecurity clause. The appropriate determination in the context of an insecurity clause is whether a reasonable person, under all the circumstances of the transaction, and motivated by good faith, would have accelerated the debt. Richards Engineers, Inc. v. Spanel, 745 P.2d 1031 (Colo. App. 1987).

4-1-310. Subordinated obligations. An obligation may be issued as subordinated to performance of another obligation of the person obligated, or a creditor may subordinate its right to performance of an obligation by agreement with either the person obligated or another creditor of the person obligated. Subordination does not create a security interest as against either the common debtor or a subordinated creditor.

Source: L. 2006: Entire article R&RE, p. 469, § 1, effective September 1.

Editor's note: This section is similar to former § 4-1-209 as it existed prior to 2006.

OFFICIAL COMMENT

Source: Former Section 1-209.

Changes from former law: This section is substantively identical to former Section 1-209. The language in that Section stating that it "shall be construed as declaring the law as it existed prior to the enactment of this Section and not as modifying it" has been deleted.

1. Billions of dollars of subordinated debt are held by the public and by institutional investors. Commonly, the subordinated debt is subordinated on issue or acquisition and is evidenced by an investment security or by a negotiable or non-negotiable note. Debt is also sometimes subordinated after it arises, either by agreement between the subordinating creditor and the debtor, by agreement between two creditors of the same debtor, or by agreement of all three parties. The subordinated creditor may be a stockholder or other "insider" interested in the common debtor; the subordinated debt may consist of accounts or other rights to payment not evidenced by any instrument. All such cases are included in the terms "subordinated obligation," "subordination," and "subordinated creditor."

2. Subordination agreements are enforceable between the parties as contracts; and in the bankruptcy of the common debtor dividends otherwise payable to the subordinated creditor are turned over to the superior creditor. This "turn-over" practice has on occasion been explained in terms of "equitable lien," "equitable assignment," or "constructive trust," but whatever the label the practice is essentially an equitable remedy and does not mean that there is a transaction "that creates a security interest in personal property . . . by contract" or a "sale of accounts, chattel paper, payment intangibles, or promissory notes" within the meaning of Section 9-109. On the other hand, nothing in this section prevents one creditor from assigning his rights to another creditor of the same debtor in such a way as to create a security interest within Article 9, where the parties so intend.

3. The enforcement of subordination agreements is largely left to supplementary principles under Section 1-103. If the subordinated debt is evidenced by a certificated security, Section 8-202(a) authorizes enforcement against purchasers on terms stated or referred to on the security certificate. If the fact of subordination is noted on a negotiable instrument, a holder under Sections 3-302 and 3-306 is subject to the term because notice precludes him from taking free of the subordination. Sections 3-302(3)(a), 3-306 and 8-317 severely limit the rights of levying creditors of a subordinated creditor in such cases.

ARTICLE 2

Sales

Editor's note: The numbering and sequencing of C.R.S. subsections do not necessarily correspond with the numbering and sequencing of subsections in the uniform act.

PART 1

SHORT TITLE, GENERAL CONSTRUCTION, AND SUBJECT MATTER

PART 2

FORM, FORMATION, AND READJUSTMENT OF CONTRACT

PART 3

GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT

PART 4

TITLE, CREDITORS, AND GOOD FAITH PURCHASERS

PART 5

PERFORMANCE

PART 6

BREACH, REPUDIATION, AND EXCUSE

PART 1

SHORT TITLE, GENERAL CONSTRUCTION, AND SUBJECT MATTER

4-2-101. Short title. This article shall be known and may be cited as the "Uniform Commercial Code - Sales".

Source: L. 65: p. 1298, § 1. **C.R.S. 1963:** § 155-2-101.

OFFICIAL COMMENT

This Article is a complete revision and modernization of the Uniform Sales Act which was promulgated by the National Conference of Commissioners on Uniform State Laws in 1906 and has been adopted in 34 states and Alaska, the District of Columbia and Hawaii.

The coverage of the present Article is much more extensive than that of the old Sales Act and extends to the various bodies of case law which have been developed both outside of and under the latter.

The arrangement of the present Article is in

terms of contract for sale and the various steps of its performance. The legal consequences are stated as following directly from the contract and action taken under it without resorting to the idea of when property or title passed or was to pass as being the determining factor. The purpose is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of words and actions of a tangible character.

ANNOTATION

Law reviews. For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965). For article, "The Uniform Commercial Code and Sales Warranties in Colorado", see 38 U. Colo. L. Rev. 7 (1965).

4-2-102. Scope - certain security and other transactions excluded from this article. (1) Unless the context otherwise requires, this article applies to transactions in goods; it does not apply to:

(a) Any transaction which, although in the form of an unconditional contract to sell or present sale, is intended to operate only as a security transaction, nor does this article impair or repeal any statute regulating sales to consumers, farmers, or other specified classes of buyers; and

(b) The donation, whether for or without valuable consideration, acquisition, preparation, transplantation, injection, or transfusion of any human tissue, organ, or blood or component thereof for or to a human being.

Source: L. 65: p. 1298, § 1. **C.R.S. 1963:** § 155-2-102. **L. 77:** Entire section R&RE, p. 313, § 5, effective January 1, 1978.

Editor's note - Colorado legislative change: Colorado added new paragraph (b). There is no counterpart to paragraph (b) in the uniform act.

Cross references: For secured transactions, sales of accounts, contract rights, and chattel paper, see article 9 of this title; for the "Uniform Anatomical Gift Act", see part 1 of article 34 of title 12; for limitation on liability regarding transplants and transfusion of blood, see § 13-22-104.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 75, Uniform Sales Act.

Changes: Section 75 has been rephrased.

Purposes of Changes and New Matter: To make it clear that:

The Article leaves substantially unaffected the law relating to purchase money security such as conditional sale or chattel mortgage though it regulates the general sales aspects of such transactions. "Security transaction" is used in the same sense as in the Article on Secured Transactions (Article 9).

Cross Reference:

Article 9.

Definitional Cross References:

"Contract". Section 4-1-201.
"Contract for sale". Section 4-2-106.
"Present sale". Section 4-2-106.
"Sale". Section 4-2-106.

ANNOTATION

Uniform commercial code does not apply to the transfer of interests in real property. Gallegos v. Graff, 32 Colo. App. 213, 508 P.2d 798 (1973).

The uniform commercial code does not supplant livestock bill of sale laws. Although livestock are "goods", the UCC does not supplant the livestock bill of sale laws concerning the passage of title to livestock. Cugnini v. Reynolds Cattle Co., 648 P.2d 159 (Colo. App. 1981), aff'd, 687 P.2d 962 (Colo. 1984).

Application of term "goods". The term "goods" as employed in this section applies to a sale by a merchant of used, as well as new, goods. Moore v. Burt Chevrolet, Inc., 39 Colo. App. 11, 563 P.2d 369 (1977).

Refinery sale did not involve sale of "goods" and thus was not covered by this article. McClanahan v. Am. Gilsonite Co., 494 F. Supp. 1334 (D. Colo. 1980).

Statutory warranties not applicable to service contracts. The statutory warranties im-

posed by the uniform sales act do not apply as a matter of law to service contracts. Samuelson v. Chutich, 187 Colo. 155, 529 P.2d 631 (1974).

A contract for the delivery of natural gas is a sale of goods within the meaning of the sales article of the uniform commercial code. KN Energy, Inc. v. Great Western Sugar Co., 698 P.2d 769 (Colo. 1985), cert. denied, 472 U.S. 1022, 105 S. Ct. 3489, 87 L. Ed.2d 623 (1985).

Transaction was within the scope of the sales article of the uniform commercial code. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 32 Colo. App. 235, 511 P.2d 912 (1973), aff'd, 184 Colo. 166, 519 P.2d 354 (1974).

Marketing agreements for manufactured products was within the scope of the sales article of the uniform commercial code where one party purchased and maintained an inventory of the manufacturer's products for direct sales to customers. William H. White Co. v. B&A Mfg. Co., 794 P.2d 1099 (Colo. App. 1990).

Applied in Smith v. Union Supply Co., 675 P.2d 333 (Colo. App. 1983).

4-2-103. Definitions and index of definitions. (1) In this article unless the context otherwise requires:

(a) "Buyer" means a person who buys or contracts to buy goods.

(b) "Good faith" in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.

(c) "Receipt" of goods means taking physical possession of them.

(d) "Seller" means a person who sells or contracts to sell goods.

(2) Other definitions applying to this article or to specified portions thereof, and the sections in which they appear are:

"Acceptance". Section 4-2-606.
"Banker's credit". Section 4-2-325.
"Between merchants". Section 4-2-104.
"Cancellation". Section 4-2-106 (4).
"Commercial unit". Section 4-2-105.
"Confirmed credit". Section 4-2-325.
"Conforming to contract". Section 4-2-106.
"Contract for sale". Section 4-2-106.
"Cover". Section 4-2-712.
"Entrusting". Section 4-2-403.
"Financing agency". Section 4-2-104.
"Future goods". Section 4-2-105.
"Goods". Section 4-2-105.
"Identification". Section 4-2-501.
"Installment contract". Section 4-2-612.
"Letter of credit". Section 4-2-325.
"Lot". Section 4-2-105.
"Merchant". Section 4-2-104.
"Overseas". Section 4-2-323.
"Person in position of seller". Section 4-2-707.
"Present sale". Section 4-2-106.
"Sale". Section 4-2-106.
"Sale on approval". Section 4-2-326.
"Sale or return". Section 4-2-326.
"Termination". Section 4-2-106.

(3) "Control" as provided in section 4-7-106 and the following definitions in other articles apply to this article:

"Check". Section 4-3-104.
"Consignee". Section 4-7-102.
"Consignor". Section 4-7-102.
"Consumer goods". Section 4-9-102.
"Dishonor". Section 4-3-502.
"Draft". Section 4-3-104.

(4) In addition, article 1 of this title contains general definitions and principles of construction and interpretation applicable throughout this article.

Source: L. 65: p. 1298, § 1. **C.R.S. 1963:** § 155-2-103. **L. 99:** (3) amended, p. 616, § 2, effective August 4. **L. 2001:** (3) amended, p. 1436, § 18, effective July 1. **L. 2006:** (3) amended, p. 490, § 3, effective September 1. **L. 2007:** (3) amended, p. 374, § 27, effective August 3.

Cross references: For the delegation of performance and assignment of rights, see § 4-2-210.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1): Section 76, Uniform Sales Act.

Changes:

The definitions of "buyer" and "seller" have been slightly rephrased, the reference in Section 76 of the prior Act to "any legal successor in interest of such person" being omitted. The definition of "receipt" is new.

Purposes of Changes and New Matter:

1. The phrase "any legal successor in interest of such person" has been eliminated since Section 2-210 of this Article, which limits some types of delegation of performance on assignment of a sales contract, makes it clear that not every such successor can be safely included in the definition. In every ordinary case, however, such successors are as of course included.

2. "Receipt" must be distinguished from delivery particularly in regard to the problems arising out of shipment of goods, whether or not the contract calls for making delivery by way of documents of title, since the seller may frequently fulfill his obligations to "deliver" even though the buyer may never "receive" the goods. Delivery with respect to documents of title is defined in Article 1 and requires transfer of physical delivery. Otherwise the many divergent incidents of delivery are handled incident by incident.

Cross References:

Point 1: See Section 4-2-210 and Comment thereon.

Point 2: Section 4-1-201.

Definitional Cross Reference:

"Person". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Upon repossession of collateral, a secured creditor becomes a legal successor in interest to its debtor, the initial buyer, and therefore becomes a buyer within the meaning of this section and may recover as a third-party beneficiary on a breach of warranty claim. Cheyenne Mountain Bank v. Whetstone Corp., 787 P.2d 210 (Colo. App. 1990).

Applied in Palmer v. A.H. Robins, Co., Inc., 684 P.2d 187 (Colo. 1984).

4-2-104. Definitions: "merchant" - "between merchants" - "financing agency". (1) "Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction, or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

(2) "Financing agency" means a bank, finance company, or other person who in the ordinary course of business makes advances against goods or documents of title or who by arrangement with either the seller or the buyer intervenes in ordinary course to make or collect payment due or claimed under the contract for sale, as by purchasing or paying the seller's draft or making advances against it or by merely taking it for collection whether or not documents of title accompany or are associated with the draft. "Financing agency" includes also a bank or other person who similarly intervenes between persons who are in the position of seller and buyer in respect to the goods (section 4-2-707).

(3) "Between merchants" means in any transaction with respect to which both parties are chargeable with the knowledge or skill of merchants.

Source: L. 65: p. 1299, § 1. **C.R.S. 1963:** § 155-2-104. **L. 2006:** (2) amended, p. 490, § 4, effective September 1.

Cross references: For the person in the position of a seller, see § 4-2-707.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None. But see Sections 15(2), (5), 16(c), 45(2) and 71, Uniform Sales Act, and Sections 35 and 37, Uniform Bills of Lading Act for examples of the policy expressly provided for in this Article.

Purposes:

1. This Article assumes that transactions between professionals in a given field require special and clear rules which may not apply to a casual or inexperienced seller or buyer. It thus adopts a policy of expressly stating rules applicable "between merchants" and "as against a merchant", wherever they are needed instead of making them depend upon the circumstances of each case as in the statutes cited above. This section lays the foundation of this policy by defining those who are to be regarded as professionals or "merchants" and by stating when a transaction is deemed to be "between merchants".

2. The term "merchant" as defined here roots in the "law merchant" concept of a professional in business. The professional status under the definition may be based upon specialized knowledge as to the goods, specialized knowledge as to business practices, or specialized knowledge as to both and which kind of specialized knowledge may be sufficient to establish the merchant status is indicated by the nature of the provisions.

The special provisions as to merchants appear only in this Article and they are of three kinds. Sections 2-201(2), 2-205, 2-207 and 2-209 dealing with the statute of frauds, firm offers, confirmatory memoranda and modification rest on normal business practices which are or ought to be typical of and familiar to any person in business. For purposes of these sections almost every person in business would, therefore, be deemed to be a "merchant" under the language "who ... by his occupation holds himself out as having knowledge or skill peculiar to the practices ... involved in the transaction ..." since the practices involved in the transaction are non-specialized business practices such as answering mail. In this type of provision, banks or even universities, for example, well may be "merchants." But even these sections only apply to a merchant in his mercantile capacity; a lawyer or bank president buying fishing tackle for his own use is not a merchant.

On the other hand, in Section 2-314 on the warranty of merchantability, such warranty is implied only "if the seller is a merchant with respect to goods of that kind." Obviously this qualification restricts the implied warranty to a much smaller group than everyone who is engaged in business and requires a professional status as to particular kinds of goods. The exception in Section 2-402(2) for retention of possession by a merchant-seller falls in the same class; as does Section 2-403(2) on entrusting of possession to a merchant "who deals in goods of that kind".

A third group of sections includes 2-103(1)(b), which provides that in the case of a merchant "good faith" includes observance of reasonable commercial standards of fair dealing in the trade; 2-327(1)(c), 2-603 and 2-605, dealing with responsibilities of merchant buyers to follow seller's instructions, etc.; 2-509 on risk of loss, and 2-609 on adequate assurance of performance. This group of sections applies to persons who are merchants under either the "practices" or the "goods" aspect of the definition of merchant.

3. The "or to whom such knowledge or skill may be attributed by his employment of an agent or broker ..." clause of the definition of merchant means that even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or business personnel who are familiar with business practices and who are equipped to take any action required.

Cross References:

Point 1: See Sections 4-1-102 and 4-1-203.

Point 2: See Sections 4-2-314, 4-2-315 and 4-2-320 to 4-2-325, of this Article, and Article 9.

Definitional Cross References:

"Bank". Section 4-1-201.
"Buyer". Section 4-2-103.
"Contract for sale". Section 4-2-106.
"Document of title". Section 4-1-201.
"Draft". Section 4-3-104.
"Goods". Section 4-2-105.
"Person". Section 4-1-201.
"Purchase". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For comment, "Implied Warranties in the Sale of Real Estate in Colorado: Rational Boundaries of the Doctrine", see 53 U. Colo. L. Rev. 137 (1981).

Where transaction "between merchants". A transaction between a manufacturer of pipe and one who regularly uses pipe in major construction projects, is a transaction between "merchants." Cement Asbestos Prods. Co. v. Hartford Accident & Indem. Co., 592 F.2d 1144 (10th Cir. 1979).

Farmer held to be "merchant" for pur-

poses of § 4-2-201 (1). Transaction between long-time farmer and merchandiser of agricultural commodities for sale of corn upon harvest was between merchants. Colorado-Kansas Grain v. Reifschneider, 817 P.2d 637 (Colo. App. 1991); Am. Pride Co-op v. Seewald, 968 P.2d 139 (Colo. App. 1998).

Applied in Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977).

4-2-105. Definitions: transferability - "goods" - "future" goods - "lot" - "commercial unit". (1) "Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (article 8 of this title), and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (section 4-2-107).

(2) Goods must be both existing and identified before any interest in them can pass. Goods which are not both existing and identified are "future" goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.

(3) There may be a sale of a part interest in existing identified goods.

(4) An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight, or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

(5) "Lot" means a parcel or a single article which is the subject matter of a separate sale of delivery, whether or not it is sufficient to perform the contract.

(6) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article (as a machine), or a set of articles (as a suite of furniture or an assortment of sizes), or a quantity (as a bale, gross, or carload), or any other unit treated in use or in the relevant market as a single whole.

Source: L. 65: p. 1300, § 1. **C.R.S. 1963:** § 155-2-105.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsections (1), (2), (3) and (4) — Sections 5, 6 and 76, Uniform Sales Act; Subsections (5) and (6) — none.

Changes: Rewritten.

Purposes of Changes and New Matter:

1. Subsection (1) on "goods": The phraseology of the prior uniform statutory provision has been changed so that:

The definition of goods is based on the concept of movability and the term "chattels personal" is not used. It is not intended to deal with things which are not fairly identifiable as movables before the contract is performed.

Growing crops are included within the definition of goods since they are frequently intended for sale. The concept of "industrial" growing crops has been abandoned, for under modern practices fruit, perennial hay, nursery stock and the like must be brought within the scope of this Article. The young of animals are also included expressly in this definition since they, too, are frequently intended for sale and may be contracted for before birth. The period of gestation of domestic animals is such that the provisions of the section on identification can apply as in the case of crops to be planted. The reason of this definition also leads to the inclusion of a wool crop or the like as "goods" subject to identification under this Article.

The exclusion of "money in which the price is to be paid" from the definition of goods does not mean that foreign currency which is included in the definition of money may not be the subject matter of a sales transaction. Goods is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment.

As to contracts to sell timber, minerals, or structures to be removed from the land Section 2-107(1) (Goods to be severed from Realty: recording) controls.

The use of the word "fixtures" is avoided in view of the diversity of definitions of that term. This Article in including within its scope "things attached to realty" adds the further test that they must be capable of severance without material harm thereto. As between the parties any identified things which fall within that definition become "goods" upon the making of the contract for sale.

"Investment securities" are expressly excluded from the coverage of this Article. It is not intended by this exclusion, however, to prevent the application of a particular section of this Article by analogy to securities (as was done with the Original Sales Act in Agar v. Orda, 264 N.Y. 248, 190 N.E. 479, 99 A.L.R. 269 (1934)) when the reason of that section makes such application sensible and the situation involved is not covered by the Article of this Act dealing specifically with such securities (Article 8).

2. References to the fact that a contract for sale can extend to future or contingent goods and that ownership in common follows the sale of a part interest have been omitted here as obvious without need for expression; hence no inference to negate these principles should be drawn from their omission.

3. Subsection (4) does not touch the question of how far an appropriation of a bulk of fungible goods may or may not satisfy the contract for sale.

4. Subsections (5) and (6) on "lot" and "commercial unit" are introduced to aid in the phrasing of later sections.

5. The question of when an identification of goods takes place is determined by the provisions of Section 2-501 and all that this section says is what kinds of goods may be the subject of a sale.

Cross References:

Point 1: Sections 4-2-107, 4-2-201, 4-2-501 and Article 8.

Point 5: Section 4-2-501.

See also Section 4-1-201.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Contract for sale". Section 4-2-106.
"Fungible". Section 4-1-201.
"Money". Section 4-1-201.
"Present sale". Section 4-2-106.
"Sale". Section 4-2-106.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "Technology Transfers: Do They Transfer Goods or Services?", see 25 Colo. Law. 13 (January 1996).

Uniform commercial code does not apply to the transfer of interests in real property. Gallegos v. Graff, 32 Colo. App. 213, 508 P.2d 798 (1973).

Uniform commercial code does not supplant livestock bill of sale laws. Although livestock are "goods", the UCC does not supplant the livestock bill of sale laws concerning the passage of title to livestock. Cugnini v. Reynolds Cattle Co., 648 P.2d 159 (Colo. App. 1981), aff'd, 687 P.2d 962 (Colo. 1984).

Refinery sale did not involve sale of "goods" and thus was not covered by this article. McClanahan v. Am. Gilsonite Co., 494 F. Supp. 1334 (D. Colo. 1980).

Hose used in hydronic radiant heating systems is a "good" for purposes of the UCC. The hose was an existing and identifiable thing which was movable at the time of identification to the contract for sale, making it a "good" for purposes of the UCC. Separate units of goods that are later incorporated into a home or other building are still goods at the time that they are procured for installation. The fact that materials sold might later be installed in a home and assume the character of fixtures does not undermine the primary purpose of the contract as one for a sale of goods. Loughridge v. Goodyear Tire & Rubber Co., 192 F. Supp.2d 1175 (D. Colo. 2002).

Automobiles held movable goods at the time of their identification to the contract for sale. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 32 Colo. App. 235, 511 P.2d 912 (1973), aff'd, 184 Colo. 166, 519 P.2d 354 (1974).

Right to use office space, right to use telephone equipment, and customer list were not "goods" and therefore not covered by the Bulk Transfers Act. Smith Office Serv., Inc. v. Kelley, 762 P.2d 791 (Colo. App. 1988).

Applied in Smith v. Union Supply Co., 675 P.2d 333 (Colo. App. 1983); Homier v. Faricy Truck & Equipment Co., 784 P.2d 798 (Colo. App. 1988).

4-2-106. Definitions: "contract" - "agreement" - "contract for sale" - "sale" - "present sale" - "conforming" to contract - "termination" - "cancellation". (1) In this article unless the context otherwise requires, "contract" and "agreement" are limited to those relating to the present or future sale of goods. "Contract for sale" includes both a present sale of goods and a contract to sell goods at a future time. A "sale" consists in the passing of title from the seller to the buyer for a price (section 4-2-401). A "present sale" means a sale which is accomplished by the making of the contract.

(2) Goods or conduct including any part of a performance are "conforming" or conform to the contract when they are in accordance with the obligations under the contract.

(3) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On "termination", all

obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) "Cancellation" occurs when either party puts an end to the contract for breach by the other, and its effect is the same as that of "termination", except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance.

Source: L. 65: p. 1301, § 1. **C.R.S. 1963:** § 155-2-106.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1) — Section 1(1) and (2), Uniform Sales Act; Subsection (2) — none, but subsection generally continues policy of Sections 11, 44 and 69, Uniform Sales Act; Subsections (3) and (4) — none.

Changes: Completely rewritten.

Purposes of Changes and New Matter:

1. Subsection (1): "Contract for sale" is used as a general concept throughout this Article, but the rights of the parties do not vary according to whether the transaction is a present sale or a contract to sell unless the Article expressly so provides.

2. Subsection (2): It is in general intended to continue the policy of requiring exact performance by the seller of his obligations as a condition to his right to require acceptance. However, the seller is in part safeguarded against surprise as a result of sudden technicality on the buyer's part by the provisions of Section 2-508 on seller's cure of improper tender or delivery. Moreover usage of trade frequently permits commercial leeways in performance and the language of the agreement itself must be read in the light of such custom or usage and also, prior course of dealing, and in a long term contract, the course of performance.

3. Subsections (3) and (4): These subsections are intended to make clear the distinction carried forward throughout this Article between termination and cancellation.

Cross References:

Point 2: Sections 4-1-203, 4-1-205, 4-2-208 and 4-2-508.

Definitional Cross References:

"Agreement". Section 4-1-201.
"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Goods". Section 4-2-105.
"Party". Section 4-1-201.
"Remedy". Section 4-1-201.
"Rights". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Nonconformity cannot be viewed as a question of the quantity and quality of goods alone, but of the performance of the totality of the seller's contractual undertaking. Irrigation Motor & Pump Co. v. Belcher, 29 Colo. App. 343, 483 P.2d 980 (1971).

Applied in R.H. Lindsay Co. v. Greager, 204 F.2d 129 (10th Cir. 1953) (decided under repealed CSA, C. 143A, § 1, uniform sales act); Waggoner v. Wilson, 31 Colo. App. 518, 507 P.2d 482 (1972); Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 32 Colo. App. 235, 511 P.2d 912 (1973); Walgreen Co. v. Charnes, 859 P.2d 235 (Colo. App. 1992).

4-2-107. Goods to be severed from realty - recording. (1) A contract for the sale of minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods within this article if they are to be severed by the seller; but until severance, a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto, but not described in subsection (1) of this section, or of timber to be cut is a contract for the sale of goods within this article, whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(3) The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale.

Source: L. 65: p. 1301, § 1. **C.R.S. 1963:** § 155-2-107. **L. 77:** (1) and (2) amended, p. 313, § 6, effective January 1, 1978.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See Section 76, Uniform Sales Act on prior policy; Section 7, Uniform Conditional Sales Act.

Purposes:

1. Subsection (1). Notice that this subsection applies only if the minerals or structures "are to be severed by the seller". If the buyer is to sever, such transactions are considered contracts affecting land and all problems of the Statute of Frauds and of the recording of land rights apply to them. Therefore, the Statute of Frauds section of this Article does not apply to such contracts though they must conform to the Statute of Frauds affecting the transfer of interests in land.

2. Subsection (2). "Things attached" to the realty which can be severed without material harm are goods within this Article regardless of who is to effect the severance. The word "fixtures" has been avoided because of the diverse definitions of this term, the test of "severance without material harm" being substituted.

The provision in subsection (3) for recording such contracts is within the purview of this Article since it is a means of preserving the buyer's rights under the contract of sale.

3. The security phases of things attached to or to become attached to realty are dealt with in the Article on Secured Transactions (Article 9) and it is to be noted that the definition of goods in that Article differs from the definition of goods in this Article.

However, both Articles treat as goods growing crops and also timber to be cut under a contract of severance.

Cross References:

Point 1: Section 4-2-201.
Point 2: Section 4-2-105.
Point 3: Articles 9 and 9-105.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Contract for sale". Section 4-2-106.
"Goods". Section 4-2-105.
"Party". Section 4-1-201.
"Present sale". Section 4-2-106.
"Rights". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Refinery sale did not involve sale of "goods" and thus was not covered by this article. McClanahan v. Am. Gilsonite Co., 494 F.Supp. 1334 (D. Colo. 1980).

PART 2

FORM, FORMATION, AND READJUSTMENT OF CONTRACT

4-2-201. Formal requirements - statute of frauds. (1) Except as otherwise provided in this section, a contract for the sale of goods for the price of five hundred dollars or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon, but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

(2) Between merchants, if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) of this section against such party unless written notice of objection to its contents is given within ten days after it is received.

(3) A contract which does not satisfy the requirements of subsection (1) of this section but which is valid in other respects is enforceable:

(a) If the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or

(b) If the party against whom enforcement is sought admits in his pleading, testimony, or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) With respect to goods for which payment has been made and accepted or which have been received and accepted (section 4-2-606).

Source: L. 65: p. 1302, § 1. **C.R.S. 1963:** § 155-2-201.

Cross references: For what constitutes acceptance of goods, see § 4-2-606.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 4, Uniform Sales Act (which was based on Section 17 of the Statute of 29 Charles II).

Changes: Completely rephrased; restricted to sale of goods. See also Sections 1-206, 8-319 and 9-203.

Purposes of Changes: The changed phraseology of this section is intended to make it clear that:

1. The required writing need not contain all the material terms of the contract and such material terms as are stated need not be precisely stated. All that is required is that the writing afford a basis for believing that the offered oral evidence rests on a real transaction. It may be written in lead pencil on a scratch pad. It need not indicate which party is the buyer and which the seller. The only term which must appear is the quantity term which need not be accurately stated but recovery is limited to the amount stated. The price, time and place of payment or delivery, the general quality of the goods, or any particular warranties may all be omitted.

Special emphasis must be placed on the permissibility of omitting the price term in view of the insistence of some courts on the express inclusion of this term even where the parties have contracted on the basis of a published price list. In many valid contracts for sale the parties do not mention the price in express terms, the buyer being bound to pay and the seller to accept a reasonable price which the trier of the fact may well be trusted to determine. Again, frequently the price is not mentioned since the parties have based their agreement on a price list or catalogue known to both of them and this list serves as an efficient safeguard against perjury. Finally, "market" prices and valuations that are current in the vicinity constitute a similar check. Thus if the price is not stated in the memorandum it can normally be supplied without danger of fraud. Of course if the "price" consists of goods rather than money the quantity of goods must be stated.

Only three definite and invariable requirements as to the memorandum are made by this subsection. First, it must evidence a contract for the sale of goods; second, it must be "signed", a word which includes any authentication which identifies the party to be charged; and third, it must specify a quantity.

2. "Partial performance" as a substitute for the required memorandum can validate the contract only for the goods which have been accepted or for which payment has been made and accepted.

Receipt and acceptance either of goods or of the price constitutes an unambiguous overt admission by both parties that a contract actually exists. If the court can make a just apportionment, therefore, the agreed price of any goods actually delivered can be recovered without a writing or, if the price has been paid, the seller can be forced to deliver an apportionable part of the goods. The overt actions of the parties make admissible evidence of the other terms of the contract necessary to a just apportionment. This is true even though the actions of the parties are not in themselves inconsistent with a different transaction such as a consignment for resale or a mere loan of money.

Part performance by the buyer requires the delivery of something by him that is accepted by the seller as such performance. Thus, part payment may be made by money or check, accepted by the seller. If the agreed price consists of goods or services, then they must also have been delivered and accepted.

3. Between merchants, failure to answer a written confirmation of a contract within ten days of receipt is tantamount to a writing under subsection (2) and is sufficient against both parties under subsection (1). The only effect, however, is to take away from the party who fails to answer the defense of the Statute of Frauds; the burden of persuading the trier of fact that a contract was in fact made orally prior to the written confirmation is unaffected. Compare the effect of a failure to reply under Section 2-207.

4. Failure to satisfy the requirements of this section does not render the contract void for all purposes, but merely prevents it from being judicially enforced in favor of a party to the contract. For example, a buyer who takes possession of goods as provided in an oral contract which the seller has not meanwhile repudiated, is not a trespasser. Nor would the Statute of

Frauds provisions of this section be a defense to a third person who wrongfully induces a party to refuse to perform an oral contract, even though the injured party cannot maintain an action for damages against the party so refusing to perform.

5. The requirement of "signing" is discussed in the comment to Section 1-201.

6. It is not necessary that the writing be delivered to anybody. It need not be signed or authenticated by both parties but it is, of course, not sufficient against one who has not signed it. Prior to a dispute no one can determine which party's signing of the memorandum may be necessary but from the time of contracting each party should be aware that to him it is signing by the other which is important.

7. If the making of a contract is admitted in court, either in a written pleading, by stipulation or by oral statement before the court, no additional writing is necessary for protection against fraud. Under this section it is no longer possible to admit the contract in court and still treat the Statute as a defense. However, the contract is not thus conclusively established. The admission so made by a party is itself evidential against him of the truth of the facts so admitted and of nothing more; as against the other party, it is not evidential at all.

Cross References:

See Sections 4-1-201, 4-2-202, 4-2-207, 4-2-209 and 4-2-304.

Definitional Cross References:

"Action". Section 4-1-201.
"Between merchants". Section 4-2-104.
"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Contract for sale". Section 4-2-106.
"Goods". Section 4-2-105.
"Notice". Section 4-1-201.
"Party". Section 4-1-201.
"Reasonable time". Section 4-1-204.
"Sale". Section 4-2-106.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Commercial Law", see 55 Den. L.J. 425 (1978).

Annotator's note. Since § 4-2-201 is similar to repealed C.R.S. 1963, § 121-1-4 (uniform sales act), a relevant case construing § 121-1-4 has been included in the annotations to this section.

This section is a parallel provision to section 38-10-112. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Acceptance must be voluntary and unconditional. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Acceptance may be inferred from the buyer's conduct in taking physical possession of the goods or some part of them. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Question of having received and accepted "part of goods" where taken and returned. In an action against a buyer to recover for failure to complete the purchase, testimony that the buyer took part of the goods away, but returned such later, is prima facie evidence warranting submission to the trier of facts of the question whether the buyer received and accepted "part of the goods" within the meaning of this section. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Provisions not expressed in writing may be established by parol. In an action for damages for failure to complete purchase where the evidence presents a question of fact on the issue of acceptance of part of the goods, such evidence, if satisfactory to the trier of facts, takes the case from under the statute of frauds; and the provisions of the contract, not expressed in the writing, may then be established by parol. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Burden on plaintiff to prove preexisting oral contract. Under this section the burden is on the plaintiff to prove that an oral contract had been entered into before the purchase order was drawn, and to constitute a sufficient writing to take the oral contract outside the statute of frauds, the writing must be "in confirmation of the contract". Nations Enters., Inc. v. Process Equip. Co., 40 Colo. App. 390, 579 P.2d 655 (1978).

Defendant has burden of proving the applicability of this section as an affirmative defense to a breach of contract claim. However, the burden switches back to the plaintiff to prove that the merchant exception in subsection (2) applies. Thus, it was reversible error for the trial court to instruct the jury that the defendant had the burden of proving that he was not a merchant and that no confirmatory writing was sent. Am. Pride Co-op v. Seewald, 968 P.2d 139 (Colo. App. 1998).

Totality of circumstances support trial court's conclusion that plaintiff intended to retain ownership of goods and that defendant's conduct did not constitute an acceptance for purposes of exception to the statute of frauds and, therefore, plaintiff's action to enforce oral contract was barred by statute of frauds. Lockhart v. Elm, 736 P.2d 429 (Colo. App. 1987).

Farmer held to be "merchant" for purposes of § 4-2-201 (1). Transaction between long-time farmer and merchandiser of agricul-

tural commodities for sale of corn upon harvest was between merchants, and written confirmation of oral agreement held sufficient to take transaction out of statute of frauds. Colorado-Kansas Grain v. Reifschneider, 817 P.2d 637 (Colo. App. 1991).

Contract contemplating both service and goods. A contract which contemplates both the performance of services and the sale of goods must be examined to determine whether its primary purpose is the sale of goods or the rendition of services. Colo. Carpet Installation, Inc. v. Palermo, 647 P.2d 686 (Colo. App. 1982), aff'd, 668 P.2d 1384 (Colo. 1983).

If the primary purpose of the contract is the sale of goods and the performance of services is merely incidental, then the statute of frauds will bar any claim which lacks the requisite writing. Colo. Carpet Installation, Inc. v. Palermo, 647 P.2d 686 (Colo. App. 1982), aff'd, 668 P.2d 1384 (Colo. 1983).

Effect of part performance. While part performance can be sufficient to remove the bar of the statute of frauds, it will remove only that portion of the contract which relates to goods which have actually been received and accepted. Colo. Carpet Installation, Inc. v. Palermo, 647 P.2d 686 (Colo. App. 1982), aff'd, 668 P.2d 1384 (Colo. 1983).

Applicability of specially manufactured goods exception. The specially manufactured goods exception, subsection (3)(a), applies only when goods are not a stock item and are unsuitable for sale to others in the ordinary course of business. Colo. Carpet Installation, Inc. v. Palermo, 647 P.2d 686 (Colo. App. 1982), aff'd, 668 P.2d 1384 (Colo. 1983).

Applied in Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977); Morrison v. Droll, 41 Colo. App. 354, 588 P.2d 383 (1978); United States ex rel. Mobile Premix Concrete, Inc. v. Santa Fe Eng'rs, Inc., 515 F. Supp. 512 (D. Colo. 1981).

4-2-202. Final written expression - parol or extrinsic evidence. Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein, may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) By course of dealing, usage of trade, or by course of performance (section 4-1-303); and

(b) By evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

Source: L. 65: p. 1303, § 1. **C.R.S. 1963:** § 155-2-202. **L. 2006:** (a) amended, p. 490, § 5, effective September 1.

Cross references: For the course of performance or practical construction, see § 4-2-208.

OFFICIAL COMMENT

1. This section definitely rejects:

(a) Any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon;

(b) The premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used; and

(c) The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.

2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.

3. Under paragraph (b) consistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all the terms. If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.

Cross References:
Point 3: Sections 4-1-205, 4-2-207, 4-2-302 and 4-2-316.
Definitional Cross References:
"Agreed" and "agreement". Section 4-1-201.
"Course of dealing". Section 4-1-205.
"Parties". Section 4-1-201.
"Term". Section 4-1-201.
"Usage of trade". Section 4-1-205.
"Written" and "writing". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Exclusion and Modification of Warranty under the U.C.C. — How to Succeed in Business Without Being Liable for Not Really Trying", see 46 Den. L.J. 579 (1969). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Parol evidence is to be excluded if the writing was intended as a final, complete, and exclusive statement of the terms of the agreement. MacGregor v. McReki, Inc., 30 Colo. App. 196, 494 P.2d 1297 (1971).

If the written expression is not "complete and exclusive", parol evidence is admissible if it relates to additional terms which are not inconsistent with a term of the written agreement. MacGregor v. McReki, Inc., 30 Colo. App. 196, 494 P.2d 1297 (1971).

There is no longer the assumption that the parties intended a writing to be the complete expression of their agreement. The assumption is to the contrary, unless the court expressly finds that the parties intended the contract to be completely integrated. Amoco Prod. Co. v. Western Slope Gas Co., 745 F.2d 303 (10th Cir. 1985); Northwest Cent. Pipeline Corp. v. JER P'ship, 943 F.2d 1219 (10th Cir. 1991).

Parol evidence admissible to vary or contradict terms of ambiguous agreement. Montoya v. Cherry Creek Dodge, Inc., 708 P.2d 491 (Colo. App. 1985); Northwest Cent. Pipeline Corp. v. JER P'ship, 943 F.2d 1219 (10th Cir. 1991).

General integration clause does not effect a waiver of a claim of negligent misrepresentation not specifically prohibited by the terms of the agreement. Parol evidence as to such misrepresentation allowed. Keller v. A.O. Smith Harvestore Prods., 819 P.2d 69 (Colo. 1991).

Parol evidence rule applicable to contract disputes had no force in a tort action alleging fraudulent misrepresentation in the inducement to execute an agreement. Bill Dreiling Motor Co. v. Shultz, 168 Colo. 59, 450 P.2d 70 (1969); Keller v. A.O. Smith Harvestore Prods., 819 P.2d 69 (Colo. 1991).

To be inconsistent, the offered evidence must contradict or negate the written terms. MacGregor v. McReki, Inc., 30 Colo. App. 196, 494 P.2d 1297 (1971).

Where a buyer alleges the existence of oral warranties prior to execution of a written contract and there is conduct following the sale which tends to show that warranties were in fact made, there is a material issue of fact for resolution, namely, whether the parties intended the written contract to be a final expression of their agreement, and, if not, what the terms actually agreed upon by the parties consisted of. Evidence of both oral warranties and the conduct of the parties subsequent to signing the contract is admissible for purpose of resolving this issue. O'Neil v. Int'l. Harvester Co., 40 Colo. App. 369, 575 P.2d 862 (1978).

Previous course of dealing considered in determining meaning of contract provisions. It is the policy of the uniform commercial code to consider previous course of dealing in determining the meaning of contract provisions. Amerine Nat'l Corp. v. Denver Feed Co., 493 F.2d 1275 (10th Cir. 1974); KN Energy, Inc. v. Great Western Sugar Co., 698 P.2d 769 (Colo. 1985), cert. denied, 472 U.S. 1022, 105 S. Ct. 3489, 87 L. Ed.2d 623 (1985).

The lack of facial ambiguity in the contract language is basically irrelevant to whether extrinsic evidence ought to be considered by the court as an initial matter. Amoco Prod. Co. v. Western Slope Gas Co., 754 F.2d 303 (10th Cir. 1985).

If a contract's construction depends upon extrinsic facts, then its terms become questions of fact, and the district court's construction will be overturned only if clearly erroneous. Amoco Prod. Co. v. Western Slope Gas Co., 745 F.2d 303 (10th Cir. 1985); Northwest Cent. Pipeline Corp. v. JER P'ship, 943 F.2d 1219 (10th Cir. 1991).

Applied in Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977); Universal Drilling Co. v. Camay Drilling Co., 737 F.2d 869 (10th Cir. 1984).

4-2-203. Seals inoperative. The affixing of a seal to a writing evidencing a contract for sale or an offer to buy or sell goods does not constitute the writing a sealed instrument, and the law with respect to sealed instruments does not apply to such a contract or offer.

Source: L. 65: p. 1303, § 1. **C.R.S. 1963:** § 155-2-203.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 3, Uniform Sales Act.
Changes: Portion pertaining to "seals" rewritten.
Purposes of Changes:

1. This section makes it clear that every effect of the seal which relates to "sealed instruments" as such is wiped out insofar as contracts for sale are concerned. However, the substantial effects of a seal, except extension of the period of limitations, may be had by appropriate drafting as in the case of firm offers (see Section 2-205).

2. This section leaves untouched any aspects of a seal which relate merely to signatures or to authentication of execution and the like. Thus, a statute providing that a purported signature gives prima facie evidence of its own authenticity or that a signature gives prima facie evidence of consideration is still applicable to sales transactions even though a seal may be held to be a signature within the meaning of such a statute. Similarly, the authorized affixing of a corporate seal bearing the corporate name to a contractual writing purporting to be made by the corporation may have effect as a signature without any reference to the law of sealed instruments.

Cross Reference:
Point 1: Section 4-2-205.
Definitional Cross References:
"Contract for sale". Section 4-2-106.
"Goods". Section 4-2-105.
"Writing". Section 4-1-201.

4-2-204. Formation in general. (1) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.

(2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.

(3) Even though one or more terms are left open, a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

Source: L. 65: p. 1303, § 1. **C.R.S. 1963:** § 155-2-204.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.
Changes: Completely rewritten by this and other sections of this Article.
Purposes of Changes:

Subsection (1) continues without change the basic policy of recognizing any manner of expression of agreement, oral, written or otherwise. The legal effect of such an agreement is, of course, qualified by other provisions of this Article.

Under subsection (1) appropriate conduct by the parties may be sufficient to establish an agreement. Subsection (2) is directed primarily to the situation where the interchanged correspondence does not disclose the exact point at which the deal was closed, but the actions of the parties indicate that a binding obligation has been undertaken.

Subsection (3) states the principle as to "open terms" underlying later sections of the Article. If the parties intend to enter into a binding agreement, this subsection recognizes that agreement as valid in law, despite missing terms, if there is any reasonably certain basis for granting a remedy. The test is not certainty as to what the parties were to do nor as to the exact amount of damages due the plaintiff. Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of "indefiniteness" are intended to be applied, this Act making provision elsewhere for missing terms needed for performance, open price, remedies and the like.

The more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement, but their actions may be frequently conclusive on the matter despite the omissions.

Cross References:
Subsection (1): Sections 1-103, 4-2-201 and 4-2-302.
Subsection (2): Sections 4-2-205 through 4-2-209.
Subsection (3): See Part 3.
Definitional Cross References:
"Agreement". Section 4-1-201.
"Contract". Section 4-1-201.
"Contract for sale". Section 4-2-106.
"Goods". Section 4-2-105.
"Party". Section 4-1-201.
"Remedy". Section 4-1-201.
"Term". Section 4-1-201.

ANNOTATION

Applied in Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977); Nations Enters., Inc. v. Process Equip. Co., 40 Colo. App. 390, 579 P.2d 655 (1978); Western Conference Resorts, Inc. v. Pease, 668 P.2d 973 (Colo. App. 1983).

4-2-205. Firm offers. An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or, if no time is stated, for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

Source: L. 65: p. 1303, § 1. **C.R.S. 1963:** § 155-2-205.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article.

Purposes of Changes:

1. This section is intended to modify the former rule which required that "firm offers" be sustained by consideration in order to bind, and to require instead that they must merely be characterized as such and expressed in signed writings.

2. The primary purpose of this section is to give effect to the deliberate intention of a merchant to make a current firm offer binding. The deliberation is shown in the case of an individualized document by the merchant's signature to the offer, and in the case of an offer included on a form supplied by the other party to the transaction by the separate signing of the particular clause which contains the offer. "Signed" here also includes authentication but the reasonableness of the authentication herein allowed must be determined in the light of the purpose of the section. The circumstances surrounding the signing may justify something less than a formal signature or initialing but typically the kind of authentication involved here would consist of a minimum of initialing of the clause involved. A handwritten memorandum on the writer's letterhead purporting in its terms to "confirm" a firm offer already made would be enough to satisfy this section, although not subscribed, since under the circumstances it could not be considered a memorandum of mere negotiation and it would adequately show its own authenticity. Similarly, an authorized telegram will suffice, and this is true even though the original draft contained only a typewritten signature. However, despite settled courses of dealing or usages of the trade whereby firm offers are made by oral communication and relied upon without more evidence, such offers remain revocable under this Article since authentication by a writing is the essence of this section.

3. This section is intended to apply to current "firm" offers and not to long term options, and an outside time limit of three months during which such offers remain irrevocable has been set. The three month period during which firm offers remain irrevocable under this section need not be stated by days or by date. If the offer states that it is "guaranteed" or "firm" until the happening of a contingency which will occur within the three month period, it will remain irrevocable until that event. A promise made for a longer period will operate under this section to bind the offeror only for the first three months of the period but may of course be renewed. If supported by consideration it may continue for as long as the parties specify. This section deals only with the offer which is not supported by consideration.

4. Protection is afforded against the inadvertent signing of a firm offer when contained in a form prepared by the offeree by requiring that such a clause be separately authenticated. If the offer clause is called to the offeror's attention and he separately authenticates it, he will be bound; Section 2-302 may operate, however, to prevent an unconscionable result which otherwise would flow from other terms appearing in the form.

5. Safeguards are provided to offer relief in the case of material mistake by virtue of the requirement of good faith and the general law of mistake.

Cross References:

Point 1: Section 4-1-102.
Point 2: Section 4-1-102.
Point 3: Section 4-2-201.
Point 5: Section 4-2-302.

Definitional Cross References:

"Goods". Section 4-2-105.
"Merchant". Section 4-2-104.
"Signed". Section 4-1-201.
"Writing". Section 4-1-201.

ANNOTATION

An offer can be "firm" even if not made in writing. This section is not intended to provide the exclusive mechanism by which a valid offer can be made. Its purpose is only to establish a type of offer that, although not supported by consideration, is nonetheless irrevocable. Scoular Co. v. Denney, 151 P.3d 615 (Colo. App. 2006).

4-2-206. Offer and acceptance in formation of contract. (1) Unless otherwise unambiguously indicated by the language or circumstances:

(a) An offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances;

(b) An order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods, but such a shipment of nonconforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

(2) Where the beginning of a requested performance is a reasonable mode of acceptance, an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

Source: L. 65: p. 1304, § 1. **C.R.S. 1963:** § 155-2-206.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten in this and other sections of this Article.

Purposes of Changes: To make it clear that:

1. Any reasonable manner of acceptance is intended to be regarded as available unless the offeror has made quite clear that it will not be acceptable. Former technical rules as to acceptance, such as requiring that telegraphic offers be accepted by telegraphed acceptance, etc., are rejected and a criterion that the acceptance be "in any manner and by any medium reasonable under the circumstances," is substituted. This section is intended to remain flexible and its applicability to be enlarged as new media of communication develop or as the more time-saving present day media come into general use.

2. Either shipment or a prompt promise to ship is made a proper means of acceptance of an offer looking to current shipment. In accordance with ordinary commercial understanding the section interprets an order looking to current shipment as allowing acceptance either by actual shipment or by a prompt promise to ship and rejects the artificial theory that only a single mode of acceptance is normally envisaged by an offer. This is true even though the language of the offer happens to be "ship at once" or the like. "Shipment" is here used in the same sense as in Section 2-504; it does not include the beginning of delivery by the seller's own truck or by messenger. But loading on the seller's own truck might be a beginning of performance under subsection (2).

3. The beginning of performance by an offeree can be effective as acceptance so as to bind the offeror only if followed within a reasonable time by notice to the offeror. Such a beginning of performance must unambiguously express the offeree's intention to engage himself. For the protection of both parties it is essential that notice follow in due course to constitute acceptance. Nothing in this section however bars the possibility that under the common law performance begun may have an intermediate effect of temporarily barring revocation of the offer, or at the offeror's option, final effect in constituting acceptance.

4. Subsection (1)(b) deals with the situation where a shipment made following an order is shown by a notification of shipment to be referable to that order but has a defect. Such a non-conforming shipment is normally to be understood as intended to close the bargain, even though it proves to have been at the same time a breach. However, the seller by stating that the shipment is non-conforming and is offered only as an accommodation to the buyer keeps the shipment or notification from operating as an acceptance.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Conforming". Section 4-2-106.
"Contract". Section 4-1-201.
"Goods". Section 4-2-105.
"Notifies". Section 4-1-201.
"Reasonable time". Section 4-1-204.

ANNOTATION

Where partial performance not adequate acceptance. In cases where the purchase order provides for an acceptance in writing, and the acceptance copy points out that the order is not valid until the acceptance copy is received, the buyer's purchase order does not invite acceptance by partial performance, and the seller's conduct in shipping some of the pumps more than a year after the date of the purchase order does not amount to acceptance. Nations Enters., Inc. v. Process Equip. Co., 40 Colo. App. 390, 579 P.2d 655 (1978).

Small print on acknowledging invoice held not part of contract. Evidence held insufficient to establish that the small print on the invoice acknowledging purchaser's order was a part of the contract. Surplus Electronics Corp. v. Gallin, 653 P.2d 752 (Colo. App. 1982).

A grain reseller's agreement to sell millet to a third party is not the beginning of a requested performance sufficient to constitute acceptance of a millet grower's offer to sell grain to the reseller. The performance desired by the millet grower was payment of money, which was not made, and nothing in the contract with the third party specified that the grain to be resold to the third party was to be grain purchased from the millet grower. Scoular Co. v. Denney, 151 P.3d 615 (Colo. App. 2006).

4-2-207. Additional terms in acceptance or confirmation. (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time, operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:

(a) The offer expressly limits acceptance to the terms of the offer;

(b) They materially alter it; or

(c) Notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case, the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this title.

Source: L. 65: p. 1304, § 1. **C.R.S. 1963:** § 155-2-207.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article.

Purposes of Changes:

1. This section is intended to deal with two typical situations. The one is the written confirmation, where an agreement has been reached either orally or by informal correspondence between the parties and is followed by one or both of the parties sending formal memoranda embodying the terms so far as agreed upon and adding terms not discussed. The other situation is offer and acceptance, in which a wire or letter expressed and intended as an acceptance or the closing of an agreement adds further minor suggestions or proposals such as "ship by Tuesday," "rush," "ship draft against bill of lading inspection allowed," or the like. A frequent example of the second situation is the exchange of printed purchase order and acceptance (sometimes called "acknowledgment") forms. Because the forms are oriented to the thinking of the respective drafting parties, the terms contained in them often do not correspond. Often the seller's form contains terms different from or additional to those set forth in the buyer's form. Nevertheless, the parties proceed with the transaction. [Comment 1 was amended in 1966.]

2. Under this Article a proposed deal which in commercial understanding has in fact been closed is recognized as a contract. Therefore, any additional matter contained in the confirmation or in the acceptance falls within subsection (2) and must be regarded as a proposal for an added term unless the acceptance is made conditional on the acceptance of the additional or different terms. [Comment 2 was amended in 1966.]

3. Whether or not additional or different terms will become part of the agreement depends upon the provisions of subsection (2). If they are such as materially to alter the original bargain, they will not be included unless ex-

pressly agreed to by the other party. If, however, they are terms which would not so change the bargain they will be incorporated unless notice of objection to them has already been given or is given within a reasonable time.

4. Examples of typical clauses which would normally "materially alter" the contract and so result in surprise or hardship if incorporated without express awareness by the other party are: a clause negating such standard warranties as that of merchantability or fitness for a particular purpose in circumstances in which either warranty normally attaches; a clause requiring a guaranty of 90 or 100 deliveries in a case such as a contract by cannery, where the usage of the trade allows greater quantity leeways; a clause reserving to the seller the power to cancel upon the buyer's failure to meet any invoice when due; a clause requiring that complaints be made in a time materially shorter than customary or reasonable.

5. Examples of clauses which involve no element of unreasonable surprise and which therefore are to be incorporated in the contract unless notice of objection is seasonably given are: a clause setting forth and perhaps enlarging slightly upon the seller's exemption due to supervening causes beyond his control, similar to those covered by the provision of this Article on merchant's excuse by failure of presupposed conditions or a clause fixing in advance any reasonable formula of proration under such circumstances; a clause fixing a reasonable time for complaints within customary limits, or in the case of a purchase for sub-sale, providing for inspection by the sub-purchaser; a clause providing for interest on overdue invoices or fixing the seller's standard credit terms where they are within the range of trade practice and do not limit any credit bargained for; a clause limiting the right of rejection for defects which fall within the customary trade tolerances for acceptance "with adjustment" or otherwise limiting remedy in a reasonable manner (see Sections 2-718 and 2-719).

6. If no answer is received within a reasonable time after additional terms are proposed, it is both fair and commercially sound to assume that their inclusion has been assented to. Where clauses on confirming forms sent by both parties conflict each party must be assumed to object to a clause of the other conflicting with one on the confirmation sent by himself. As a result the requirement that there be notice of objection which is found in subsection (2) is satisfied and the conflicting terms do not become a part of the contract. The contract then consists of the terms originally expressly agreed to, terms on which the confirmations agree, and terms supplied by this Act, including subsection (2). The written confirmation is also subject to Section 2-201. Under that section a failure to respond permits enforcement of a prior oral agreement; under this section a failure to respond permits additional terms to become part of the agreement. [Comment 6 was amended in 1966.]

7. In many cases, as where goods are shipped, accepted and paid for before any dispute arises, there is no question whether a contract has been made. In such cases, where the writings of the parties do not establish a contract, it is not necessary to determine which act or document constituted the offer and which the acceptance. See Section 2-204. The only question is what terms are included in the contract, and subsection (3) furnishes the governing rule. [Comment 7 was added in 1966.]

Cross References:

See generally Section 4-2-302.

Point 5: Sections 4-2-513, 4-2-602, 4-2-607, 4-2-609, 4-2-612, 4-2-614, 4-2-615, 4-2-616, 4-2-718 and 4-2-719.

Point 6: Sections 1-102 and 4-2-104.

Definitional Cross References:

"Between merchants". Section 4-2-104.
"Contract". Section 4-1-201.
"Notification". Section 4-1-201.
"Reasonable time". Section 4-1-204.
"Seasonably". Section 4-1-204.
"Send". Section 4-1-201.
"Term". Section 4-1-201.
"Written". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Commercial Law", see 55 Den. L.J. 425 (1978). For article, "The 'Battle of the Forms' Under the Colorado Uniform Commercial Code", see 11 Colo. Law. 78 (1982).

Counteroffer. Under this section, whenever an offeree's acceptance contains terms that materially alter the contract, and the offeree had conditioned his participation on the offeror's acceptance of such terms, the offeree's response becomes a counteroffer, to be accepted or rejected by the offeror, rather than an acknowledgment of the original offer. Master Palletizer Sys. v. T.S. Ragsdale Co., 725 F. Supp. 1525 (D. Colo. 1989).

Effect of addition of material term on contract. Under this section, in transactions between merchants the addition of a material term does not void the contract but the other party is not bound by the new term. Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977).

Test for determining materiality consists of three-part analysis to find subjective surprise, objective surprise, and hardship. Avedon Eng'g, Inc. v. Seatex, 112 F. Supp.2d 1090 (D. Colo. 2000).

Material alteration not found. Boilerplate "future transactions" clause, requiring future transactions between the parties to be governed by written terms printed on sales confirmation form unless superseded by a signed contract, was held not to "materially alter" the agreement and therefore was enforceable although not expressly bargained for. Avedon Eng'g, Inc. v. Seatex, 112 F. Supp.2d 1090 (D. Colo. 2000).

Material alteration not found. Boilerplate arbitration clause was held not to "materially alter" the agreement and therefore was enforceable although not expressly bargained for. Avedon Eng'g, Inc. v. Seatex, 112 F. Supp.2d 1090 (D. Colo. 2000).

Material alteration found. Boilerplate clause purporting to reduce limitation period from three years to one year, contrary to state statute, was held to "materially alter" the agreement and therefore was not enforceable. Avedon Eng'g, Inc. v. Seatex, 112 F. Supp.2d 1090 (D. Colo. 2000).

Material alteration held not agreed to and therefore is not binding. Flight Sys. v. Elgood-Mayo Corp., 660 P.2d 909 (Colo. App. 1982).

Small print on acknowledging invoice held not part of contract. Evidence held insufficient to establish that the small print on the invoice acknowledging purchaser's order was a part of the contract. Surplus Electronics Corp. v. Gallin, 653 P.2d 752 (Colo. App. 1982).

Penalty interest and attorney fee provisions included on an invoice which constitutes written confirmation of terms orally agreed to by the parties do not materially alter a contract and thus become a part thereof absent objection to such terms. Offen, Inc. v. Rocky Mountain Constructors, 765 P.2d 600 (Colo. App. 1988).

After defendant was provided a copy of the manufacturer's statement and disclaimer of warranty, those items became part of the agreement between the parties. Graham Hydraulic v. Stewart & Stevenson, 797 P.2d 835 (Colo. App. 1990).

Whether a contract is established pursuant to subsection (3) is applied in Westinghouse Elec. Corp. v. Nielsons, Inc., 647 F. Supp. 896 (D. Colo. 1986).

4-2-208. Course of performance or practical construction. (1) Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(2) The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (section 4-1-303).

(3) Subject to the provisions of section 4-2-209 on modification and waiver, such course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

Source: L. 65: p. 1304, § 1. **C.R.S. 1963:** § 155-2-208. **L. 2006:** (2) amended, p. 490, § 6, effective September 1.

OFFICIAL COMMENT

1. The parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was. This section thus rounds out the set of factors which determines the meaning of the "agreement" and therefore also of the "unless otherwise agreed" qualification to various provisions of this Article.

2. Under this section a course of performance is always relevant to determine the meaning of the agreement. Express mention of course of performance elsewhere in this Article carries no contrary implication when there is a failure to refer to it in other sections.

3. Where it is difficult to determine whether a particular act merely sheds light on the meaning of the agreement or represents a waiver of a term of the agreement, the preference is in favor of "waiver" whenever such construction, plus the application of the provisions on the reinstatement of rights waived (see Section 2-209), is needed to preserve the flexible character of commercial contracts and to prevent surprise or other hardship.

4. A single occasion of conduct does not fall within the language of this section but other sections such as the ones on silence after acceptance and failure to specify particular defects can affect the parties' rights on a single occasion

(see Sections 2-605 and 2-607).
Cross References:
Point 1: Section 4-1-201.
Point 2: Section 4-2-202.
Point 3: Sections 4-2-209, 4-2-601 and 4-2-607.
Point 4: Sections 4-2-605 and 4-2-607.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

When evidence admissible. Evidence of course of dealing and course of performance is admissible if it does not directly contradict the terms of a written agreement, but merely explains or supplements it. Great W. Sugar Co. v. Northern Natural Gas Co., 661 P.2d 684 (Colo. App. 1982), aff'd sub nom. KN Energy, Inc. v. Great Western Sugar Co., 698 P.2d 769 (Colo. 1985), cert. denied, 472 U.S. 1022, 105 S. Ct. 3489, 87 L. Ed.2d 623 (1985).

It is the policy of the UCC to consider the previous course of dealing in determining the meaning of contract provisions. Great W. Sugar Co. v. Northern Natural Gas Co., 661 P.2d 684 (Colo. App. 1982), aff'd sub nom. KN Energy, Inc. v. Great Western Sugar Co., 698 P.2d 769 (Colo. 1985), cert. denied, 472 U.S. 1022, 105 S. Ct. 3489, 87 L. Ed.2d 623 (1985).

Applied in U.S., Trans-Colorado Concrete v. Midwest Const. Co., 653 F. Supp. 903 (D. Colo. 1987).

4-2-209. Modification, rescission, and waiver. (1) An agreement modifying a contract within this article needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of the statute of frauds section of this article (section 4-2-201) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) of this section, it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

Source: L. 65: p. 1305, § 1. **C.R.S. 1963:** § 155-2-209.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1) — Compare Section 1, Uniform Written Obligations Act; Subsections (2) to (5) — none.
Purposes of Changes and New Matter:

1. This section seeks to protect and make effective all necessary and desirable modifications of sales contracts without regard to the technicalities which at present hamper such adjustments.

2. Subsection (1) provides that an agreement modifying a sales contract needs no consideration to be binding.

However, modifications made thereunder must meet the test of good faith imposed by this Act. The effective use of bad faith to escape performance on the original contract terms is barred, and the extortion of a "modification" without legitimate commercial reason is ineffective as a violation of the duty of good faith. Nor can a mere technical consideration support a modification made in bad faith.

The test of "good faith" between merchants or as against merchants includes "observance of reasonable commercial standards of fair dealing in the trade" (Section 2-103), and may in some situations require an objectively demonstrable reason for seeking a modification. But such matters as a market shift which makes performance come to involve a loss may provide such a reason even though there is no such unforeseen difficulty as would make out a legal excuse from performance under Sections 2-615 and 2-616.

3. Subsections (2) and (3) are intended to protect against false allegations of oral modifications. "Modification or rescission" includes abandonment or other change by mutual consent, contrary to the decision in Green v.

Doniger, 300 N.Y. 238, 90 N.E.2d 56 (1949); it does not include unilateral "termination" or "cancellation" as defined in Section 2-106.

The Statute of Frauds provisions of this Article are expressly applied to modifications by subsection (3). Under those provisions the "delivery and acceptance" test is limited to the goods which have been accepted, that is, to the past. "Modification" for the future cannot therefore be conjured up by oral testimony if the price involved is $500.00 or more since such modification must be shown at least by an authenticated memo. And since a memo is limited in its effect to the quantity of goods set forth in it there is safeguard against oral evidence.

Subsection (2) permits the parties in effect to make their own Statute of Frauds as regards any future modification of the contract by giving effect to a clause in a signed agreement which expressly requires any modification to be by signed writing. But note that if a consumer is to be held to such a clause on a form supplied by a merchant it must be separately signed.

4. Subsection (4) is intended, despite the provisions of subsections (2) and (3), to prevent contractual provisions excluding modification except by a signed writing from limiting in other respects the legal effect of the parties' actual later conduct. The effect of such conduct as a waiver is further regulated in subsection (5).

Cross References:

Point 1: Section 4-1-203.

Point 2: Sections 4-1-201, 4-1-203, 4-2-615 and 4-2-616.

Point 3: Sections 4-2-106, 4-2-201 and 4-2-202.

Point 4: Sections 4-2-202 and 4-2-208.

Definitional Cross References:

"Agreement". Section 4-1-201.

"Between merchants". Section 4-2-104.

"Contract". Section 4-1-201.

"Notification". Section 4-1-201.

"Signed". Section 4-1-201.

"Term". Section 4-1-201.

"Writing". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Meaning of "waiver". The term "waiver" as used in this section has been accorded its usual meaning, namely, the intentional relinquishment of a known right. Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

A waiver may be shown by a course of conduct or by oral statement. Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

A waiver can be shown by unequivocal conduct or statements betraying an intent to relinquish known rights. Jelen and Son, Inc. v. Bandimere, 801 P.2d 1182 (Colo. 1990).

Applied in United States ex rel. Mobile Premix Concrete, Inc. v. Santa Fe Eng'rs, Inc., 515 F. Supp. 512 (D. Colo. 1981).

4-2-210. Delegation of performance - assignment of rights. (1) A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.

(2) Except as otherwise provided in section 4-9-406, unless otherwise agreed, all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him or her by his or her contract, or impair materially his or her chance of obtaining return performance. A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his or her entire obligation can be assigned despite agreement otherwise.

(2.5) The creation, attachment, perfection, or enforcement of a security interest in the seller's interest under a contract is not a transfer that materially changes the duty of or increases materially the burden or risk imposed on the buyer or impairs materially the buyer's chance of obtaining return performance within the purview of subsection (2) of this section unless, and then only to the extent that enforcement actually results in a delegation of material performance of the seller. Even in that event, the creation, attachment, perfection, and enforcement of the security interest remain effective, but (i) the seller is liable to the buyer for damages caused by the delegation to the extent that the damages could not reasonably be prevented by the buyer, and (ii) a court having jurisdiction may grant other appropriate relief, including cancellation of the contract for sale or an injunction against enforcement of the security interest or consummation of the enforcement.

(3) Unless the circumstances indicate the contrary, a prohibition of assignment of "the contract" is to be construed as barring only the delegation to the assignee of the assignor's performance.

(4) An assignment of "the contract" or of "all my rights under the contract" or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

(5) The other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the assignor demand assurances from the assignee (section 4-2-609).

Source: L. 65: p. 1305, § 1. **C.R.S. 1963:** § 155-2-210. **L. 2001:** (2) amended and (2.5) added, p. 1436, § 19, effective July 1.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Generally, this section recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods.

2. Delegation of performance, either in conjunction with an assignment or otherwise, is provided for by subsection (1) where no substantial reason can be shown as to why the delegated performance will not be as satisfactory as personal performance.

3. Under subsection (2) rights which are no longer executory such as a right to damages for breach or a right to payment of an "account" as defined in the Article on Secured Transactions (Article 9) may be assigned although the agreement prohibits assignment. In such cases no question of delegation of any performance is involved. The assignment of a "contract right" as defined in the Article on Secured Transactions (Article 9) is not covered by this subsection.

4. The nature of the contract or the circumstances of the case, however, may bar assignment of the contract even where delegation of performance is not involved. This Article and this section are intended to clarify this problem, particularly in cases dealing with output requirement and exclusive dealing contracts. In the first place the section on requirements and exclusive dealing removes from the construction of the original contract most of the "personal discretion" element by substituting the reasonably objective standard of good faith operation of the plant or business to be supplied. Secondly, the section on insecurity and assurances, which is specifically referred to in subsection (5) of this section, frees the other party from the doubts and uncertainty which may afflict him under an assignment of the character in question by permitting him to demand adequate assurance of due performance without which he may suspend his own performance. Subsection (5) is not in any way intended to limit the effect of the section on insecurity and assurances and the word "performance" includes the giving of orders under a requirements contract. Of course, in any case where a material personal discretion is sought to be transferred, effective assignment is barred by subsection (2).

5. Subsection (4) lays down a general rule of construction distinguishing between a normal commercial assignment, which substitutes the assignee for the assignor both as to rights and duties, and a financing assignment in which only the assignor's rights are transferred.

This Article takes no position on the possibility of extending some recognition or power to the original parties to work out normal commercial readjustments of the contract in the case of financing assignments even after the original obligor has been notified of the assignment. This question is dealt with in the Article on Secured Transactions (Article 9).

6. Subsection (5) recognizes that the non-assigning original party has a stake in the reliability of the person with whom he has closed the original contract, and is, therefore, entitled to due assurance that any delegated performance will be properly forthcoming.

7. This section is not intended as a complete statement of the law of delegation and assignment but is limited to clarifying a few points doubtful under the case law. Particularly, neither this section nor this Article touches directly on such questions as the need or effect of notice of the assignment, the rights of successive assignees, or any question of the form of an assignment, either as between the parties or as against any third parties. Some of these questions are dealt with in Article 9.

Cross References:

Point 3: Articles 5 and 9.
Point 4: Sections 4-2-306 and 4-2-609.
Point 5: Article 9, Sections 9-317 and 9-318.
Point 7: Article 9.

Definitional Cross References:
"Agreement". Section 4-1-201.
"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Party". Section 4-1-201.
"Rights". Section 4-1-201.
"Seller". Section 4-2-103.
"Term". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

PART 3

GENERAL OBLIGATION AND CONSTRUCTION OF CONTRACT

4-2-301. General obligations of parties. The obligation of the seller is to transfer and deliver and that of the buyer is to accept and pay in accordance with the contract.

Source: L. 65: p. 1306, § 1. **C.R.S. 1963:** § 155-2-301.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 11 and 41, Uniform Sales Act.
Changes: Rewritten.
Purposes of Changes:
This section uses the term "obligation" in contrast to the term "duty" in order to provide for the "condition" aspects of delivery and payment insofar as they are not modified by other sections of this Article such as those on cure of tender. It thus replaces not only the general provisions of the Uniform Sales Act on the parties' duties, but also the general provisions of that Act on the effect of conditions. In order to determine what is "in accordance with the contract" under this Article usage of trade, course of dealing and performance, and the general background of circumstances must be given due consideration in conjunction with the lay meaning of the words used to define the scope of the conditions and duties.
Cross References:
Section 4-1-106. See also Sections 4-1-205, 4-2-208, 4-2-209, 4-2-508 and 4-2-612.
Definitional Cross References:
"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Party". Section 4-1-201.
"Seller". Section 4-2-103.

4-2-302. Unconscionable contract or clause. (1) If the court, as a matter of law, finds the contract or any clause of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable, the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect, to aid the court in making the determination.

Source: L. 65: p. 1306, § 1. **C.R.S. 1963:** § 155-2-302.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes:
1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the light of the general commercial

background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (2) makes it clear that it is proper for the court to hear evidence upon these questions. The principle is one of the prevention of oppression and unfair surprise (Cf. Campbell Soup Co. v. Wentz, 172 F.2d 80, 3d Cir. 1948) and not of disturbance of allocation of risks because of superior bargaining power. The underlying basis of this section is illustrated by the results in cases such as the following:

Kansas City Wholesale Grocery Co. v. Weber Packing Corporation, 93 Utah 414, 73 P.2d 1272 (1937), where a clause limiting time for complaints was held inapplicable to latent defects in a shipment of catsup which could be discovered only by microscopic analysis; Hardy v. General Motors Acceptance Corporation, 38 Ga.App. 463, 144 S.E. 327 (1928), holding that a disclaimer of warranty clause applied only to express warranties, thus letting in a fair implied warranty; Andrews Bros. v. Singer & Co. (1934 CA) 1 K.B. 17, holding that where a car with substantial mileage was delivered instead of a "new" car, a disclaimer of warranties, including those "implied," left unaffected an "express obligation" on the description, even though the Sale of Goods Act called such an implied warranty; New Prague Flouring Mill Co. v. G. A. Spears, 194 Iowa 417, 189 N.W. 815 (1922), holding that a clause permitting the seller, upon the buyer's failure to supply shipping instructions, to cancel, ship, or allow delivery date to be indefinitely postponed 30 days at a time by the inaction, does not indefinitely postpone the date of measuring damages for the buyer's breach, to the seller's advantage; and Kansas Flour Mills Co. v. Dirks, 100 Kan. 376, 164 P. 273 (1917), where under a similar clause in a rising market the court permitted the buyer to measure his damages for non-delivery at the end of only one 30 day postponement; Green v. Arcos, Ltd. (1931 CA) 47 T.L.R. 336, where a blanket clause prohibiting rejection of shipments by the buyer was restricted to apply to shipments where discrepancies represented merely mercantile variations; Meyer v. Packard Cleveland Motor Co., 106 Ohio St. 328, 140 N.E. 118 (1922), in which the court held that a "waiver" of all agreements not specified did not preclude implied warranty of fitness of a rebuilt dump truck for ordinary use as a dump truck; Austin Co. v. J. H. Tillman Co., 104 Or. 541, 209 P. 131 (1922), where a clause limiting the buyer's remedy to return was held to be applicable only if the seller had delivered a machine needed for a construction job which reasonably met the contract description; Bekkevold v. Potts, 173 Minn. 87, 216 N.W. 790, 59 A.L.R. 1164 (1927), refusing to allow warranty of fitness for purpose imposed by law to be negated by clause excluding all warranties "made" by the seller; Robert A. Munroe & Co. v. Meyer (1930) 2 K.B. 312, holding that the warranty of description overrides a clause reading "with all faults and defects" where adulterated meat not up to the contract description was delivered.

2. Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

3. The present section is addressed to the court, and the decision is to be made by it. The commercial evidence referred to in subsection (2) is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is to be submitted to the general triers of the facts.

Definitional Cross Reference:

"Contract". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Exclusion and Modification of Warranty under the U.C.C. — How to Succeed in Business Without Being Liable for Not Really Trying", see 46 Den. L.J. 579 (1969). For note, "Exculpatory Clauses and Public Policy: A Judicial Dilemma", see 53 U. Colo. L. Rev. 793 (1982). For article, "When are Merger Clauses Unconscionable?", see 64 Den. U.L. Rev. 529 (1988).

Finding of unconscionability is a question of law. Mullan v. Quickie Aircraft Corp., 797 F.2d 845 (10th Cir. 1986).

In order to support a finding of unconscionability, there must be evidence of some overreaching on the part of one of the parties such as that which results from an inequality of bargaining power or under other circumstances in which there is an absence of meaningful choice on the part of one of the parties, together with contract terms which are unreasonably favorable to that party. McMillion v. McMillion, 31 Colo. App. 33, 522 P.2d 125 (1974); Davis v. M.L.G. Corp., 712 P.2d 985 (Colo. 1986); Mullan v. Quickie Aircraft Corp., 797 F.2d 845 (10th Cir. 1986); Leprino v. Intermountain Brick Co., 759 P.2d 835 (Colo. App. 1988).

Whether contract was unconscionable is discussed in Mullan v. Quickie Aircraft Corp.,

797 F.2d 845 (10th Cir. 1986); Leprino v. Intermountain Brick Co., 759 P.2d 835 (Colo. App. 1988).

Applied in In re Stokes, 43 Colo. App. 461, 608 P.2d 824 (1979); In re Manzo, 659 P.2d 669 (Colo. 1983).

4-2-303. Allocation or division of risks. Where this article allocates a risk or a burden as between the parties "unless otherwise agreed", the agreement may not only shift the allocation but may also divide the risk or burden.

Source: L. 65: p. 1307, § 1. **C.R.S. 1963:** § 155-2-303.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section is intended to make it clear that the parties may modify or allocate "unless otherwise agreed" risks or burdens imposed by this Article as they desire, always subject, of course, to the provisions on unconscionability.

Compare Section 1-102(4).

2. The risk or burden may be divided by the express terms of the agreement or by the attending circumstances, since under the definition of "agreement" in this Act the circumstances surrounding the transaction as well as the express language used by the parties enter into the meaning and substance of the agreement.

Cross References:

Point 1: Sections 4-1-102, 4-2-302.

Point 2: Section 4-1-201.

Definitional Cross References:

"Party". Section 4-1-201.

"Agreement". Section 4-1-201.

4-2-304. Price payable in money, goods, realty, or otherwise. (1) The price can be made payable in money or otherwise. If it is payable in whole or in part in goods, each party is a seller of the goods which he is to transfer.

(2) Even though all or part of the price is payable in an interest in realty, the transfer of the goods and the seller's obligations with reference to them are subject to this article, but not the transfer of the interest in realty or the transferor's obligations in connection therewith.

Source: L. 65: p. 1307, § 1. **C.R.S. 1963:** § 155-2-304.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsections (2) and (3) of Section 9, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes:

1. This section corrects the phrasing of the Uniform Sales Act so as to avoid misconstruction and produce greater accuracy in commercial result. While it continues the essential intent and purpose of the Uniform Sales Act it rejects any purely verbalistic construction in disregard of the underlying reason of the provisions.

2. Under subsection (1) the provisions of this Article are applicable to transactions where the "price" of goods is payable in something other than money. This does not mean, however, that this whole Article applies automatically and in its entirety simply because an agreed transfer of title to goods is not a gift. The basic purposes and reasons of the Article must always be considered in determining the applicability of any of its provisions.

3. Subsection (2) lays down the general principle that when goods are to be exchanged for realty, the provisions of this Article apply only to those aspects of the transaction which concern the transfer of title to goods but do not affect the transfer of the realty since the detailed regulation of various particular contracts which fall outside the scope of this Article is left to the courts and other legislation. However, the complexities of these situations may be such that each must be analyzed in the light of the underlying reasons in order to determine the applicable principles. Local statutes dealing with realty are not to be lightly disregarded or altered by language of this Article. In contrast, this Article declares definite policies in regard to certain matters legitimately within its scope though concerned with real property situations, and in those instances the provisions of this Article control.

Cross References:

Point 1: Section 4-1-102.

Point 3: Sections 4-1-102, 4-1-103, 4-1-104 and 4-2-107.

Definitional Cross References:
"Goods". Section 4-2-105.
"Money". Section 4-1-201.
"Party". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Applied in Jelen and Son, Inc. v. Bandimere, 801 P.2d 1182 (Colo. 1990).

4-2-305. Open price term. (1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if:

(a) Nothing is said as to price; or

(b) The price is left to be agreed by the parties and they fail to agree; or

(c) The price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party, the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed, there is no contract. In such a case, the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

Source: L. 65: p. 1307, § 1. **C.R.S. 1963:** § 155-2-305.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 9 and 10, Uniform Sales Act.
Changes: Completely rewritten.
Purposes of Changes:

1. This section applies when the price term is left open on the making of an agreement which is nevertheless intended by the parties to be a binding agreement. This Article rejects in these instances the formula that "an agreement to agree is unenforceable" if the case falls within subsection (1) of this section, and rejects also defeating such agreements on the ground of "indefiniteness". Instead this Article recognizes the dominant intention of the parties to have the deal continue to be binding upon both. As to future performance, since this Article recognizes remedies such as cover (Section 2-712), resale (Section 2-706) and specific performance (Section 2-716) which go beyond any mere arithmetic as between contract price and market price, there is usually a "reasonably certain basis for granting an appropriate remedy for breach" so that the contract need not fail for indefiniteness.

2. Under some circumstances the postponement of agreement on price will mean that no deal has really been concluded, and this is made express in the preamble of subsection (1) ("The parties **if they so intend**") and in subsection (4). Whether or not this is so is, in most cases, a question to be determined by the trier of fact.

3. Subsection (2), dealing with the situation where the price is to be fixed by one party rejects the uncommercial idea that an agreement that the seller may fix the price means that he may fix any price he may wish by the express qualification that the price so fixed must be fixed in good faith. Good faith includes observance of reasonable commercial standards of fair dealing in the trade if the party is a merchant. (Section 2-103). But in the normal case a "posted price" or a future seller's or buyer's "given price," "price in effect," "market price," or the like satisfies the good faith requirement.

4. The section recognizes that there may be cases in which a particular person's judgment is not chosen merely as a barometer or index of a fair price but is an essential condition to the parties' intent to make any contract at all. For example, the case where a known and trusted expert is to "value" a particular painting for which there is no market standard differs sharply from the situation where a named expert is to determine the grade of cotton, and the difference would support a finding that in the one the parties did not intend to make a binding agreement if that expert were unavailable whereas in the other they did so intend. Other circumstances would of course affect the validity of such a finding.

5. Under subsection (3), wrongful interference by one party with any agreed machinery for price fixing in the contract may be treated by the other party as a repudiation justifying cancellation, or merely as a failure to take cooperative action thus shifting to the aggrieved party the reasonable leeway in fixing the price.

6. Throughout the entire section, the purpose is to give effect to the agreement which has been made. That effect, however, is always conditioned by the requirement of good faith action which is made an inherent part of all contracts within this Act. (Section 1-203).

Cross References:

Point 1: Sections 4-2-204(3), 4-2-706, 4-2-712 and 4-2-716.

Point 3: Section 4-2-103.

Point 5: Sections 4-2-311 and 4-2-610.

Point 6: Section 4-1-203.

Definitional Cross References:

"Agreement". Section 4-1-201.
"Burden of establishing". Section 4-1-201.
"Buyer". Section 4-2-103.
"Cancellation". Section 4-2-106.
"Contract". Section 4-1-201.
"Contract for sale". Section 4-2-106.
"Fault". Section 4-1-201.
"Goods". Section 4-2-105.
"Party". Section 4-1-201.
"Receipt of goods". Section 4-2-103.
"Seller". Section 4-2-103.
"Term". Section 4-1-201.

ANNOTATION

The question of a reasonable price for goods pursuant to this section is a question for a jury. Fischer Imaging Corp. v. General Elec. Co., 187 F.3d 1165 (10th Cir. 1999).

4-2-306. Output, requirements, and exclusive dealings. (1) A term which measures the quantity by the output of the seller or the requirements of the buyer, means such actual output or requirements as may occur in good faith; except that no quantity unreasonably disproportionate to any stated estimate or, in the absence of a stated estimate, to any normal or otherwise comparable prior output or requirements, may be tendered or demanded.

(2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes, unless otherwise agreed, an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.

Source: L. 65: p. 1307, § 1. **C.R.S. 1963:** § 155-2-306.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Subsection (1) of this section, in regard to output and requirements, applies to this specific problem the general approach of this Act which requires the reading of commercial background and intent into the language of any agreement and demands good faith in the performance of that agreement. It applies to such contracts of nonproducing establishments such as dealers or distributors as well as to manufacturing concerns.

2. Under this Article, a contract for output or requirements is not too indefinite since it is held to mean the actual good faith output or requirements of the particular party. Nor does such a contract lack mutuality of obligation since, under this section, the party who will determine quantity is required to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade so that his output or requirements will approximate a reasonably foreseeable figure. Reasonable elasticity in the requirements is expressly envisaged by this section and good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance. A shut-down by a requirements buyer for lack of orders might be permissible when a shut-down merely to curtail losses would not. The essential test is whether the party is acting in good faith. Similarly, a sudden expansion of the plant by which requirements are to be measured would not be included within the scope of the contract as made but normal expansion undertaken in good faith would be within the scope of this section. One of the factors in an expansion situation would be whether the market price had risen greatly in a case in which the requirements contract contained a fixed price. Reasonable variation of an extreme sort is exemplified in Southwest Natural Gas Co. v. Oklahoma Portland Cement Co., 102 F.2d 630 (C.C.A.10, 1939). This Article takes no position as to whether a requirements contract is a provable claim in bankruptcy.

3. If an estimate of output or requirements is included in the agreement, no quantity unreasonably disproportionate to it may be tendered or demanded. Any minimum or maximum set by the agreement shows a clear limit on the in-

tended elasticity. In similar fashion, the agreed estimate is to be regarded as a center around which the parties intend the variation to occur.

4. When an enterprise is sold, the question may arise whether the buyer is bound by an existing output or requirements contract. That question is outside the scope of this Article, and is to be determined on other principles of law. Assuming that the contract continues, the output or requirements in the hands of the new owner continue to be measured by the actual good faith output or requirements under the normal operation of the enterprise prior to sale. The sale itself is not grounds for sudden expansion or decrease.

5. Subsection (2), on exclusive dealing, makes explicit the commercial rule embodied in this Act under which the parties to such contracts are held to have impliedly, even when not expressly, bound themselves to use reasonable diligence as well as good faith in their performance of the contract. Under such contracts the exclusive agent is required, although no express commitment has been made, to use reasonable effort and due diligence in the expansion of the market or the promotion of the product, as the case may be. The principal is expected under such a contract to refrain from supplying any other dealer or agent within the exclusive territory. An exclusive dealing agreement brings into play all of the good faith aspects of the output and requirement problems of subsection (1). It also raises questions of insecurity and right to adequate assurance under this Article.

Cross References:

Point 4: Section 4-2-210.

Point 5: Sections 4-1-203 and 4-2-609.

Definitional Cross References:

"Agreement". Section 4-1-201.

"Buyer". Section 4-2-103.

"Contract for sale". Section 4-2-106.

"Good faith". Section 4-1-201.

"Goods". Section 4-2-105.

"Party". Section 4-1-201.

"Term". Section 4-1-201.

"Seller". Section 4-2-103.

ANNOTATION

"Best efforts" requirement enforced. The "best efforts" requirement of an exclusive distributorship contract, governed by subsection (2), was held not negated by agreement of the parties, and remained as an obligation of the distributors. Stone v. Caroselli, 653 P.2d 754 (Colo. App. 1982).

4-2-307. Delivery in single lot or several lots. Unless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery, and payment is due only on such tender; but where the circumstances give either party the right to make or demand delivery in lots, the price, if it can be apportioned, may be demanded for each lot.

Source: L. 65: p. 1308, § 1. **C.R.S. 1963:** § 155-2-307.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 45(1), Uniform Sales Act.

Changes: Rewritten and expanded.

Purposes of Changes:

1. This section applies where the parties have not specifically agreed whether delivery and payment are to be by lots and generally continues the essential intent of original Act, Section 45(1) by assuming that the parties intended delivery to be in a single lot.

2. Where the actual agreement or the circumstances do not indicate otherwise, delivery in lots is not permitted under this section and the buyer is properly entitled to reject for a deficiency in the tender, subject to any privilege in the seller to cure the tender.

3. The "but" clause of this section goes to the case in which it is not commercially feasible to deliver or to receive the goods in a single lot as for example, where a contract calls for the shipment of ten carloads of coal and only three cars are available at a given time. Similarly, in a contract involving brick necessary to build a building the buyer's storage space may be limited so that it would be impossible to receive the entire amount of brick at once, or it may be necessary to assemble the goods as in the case of cattle on the range, or to mine them.

In such cases, a partial delivery is not subject to rejection for the defect in quantity alone, if the circumstances do not indicate a repudiation or default by the seller as to the expected balance or do not give the buyer ground for suspending his performance because of insecurity under the provisions of Section 2-609. However, in such cases the undelivered balance of goods under the contract must be forthcoming within a reasonable time and in a reasonable manner according to the policy of Section 2-503 on manner of tender of delivery. This is reinforced by the express provisions of Section 2-608 that if a lot has been accepted on the reasonable

assumption that its nonconformity will be cured, the acceptance may be revoked if the cure does not seasonably occur. The section rejects the rule of Kelly Construction Co. v. Hackensack Brick Co., 91 N.J.L. 585, 103 A. 417, 2 A.L.R. 685 (1918) and approves the result in Lynn M. Ranger, Inc. v. Gildersleeve, 106 Conn. 372, 138 A. 142 (1927) in which a contract was made for six carloads of coal then rolling from the mines and consigned to the seller but the seller agreed to divert the carloads to the buyer as soon as the car numbers became known to him. He arranged a diversion of two cars and then notified the buyer who then repudiated the contract. The seller was held to be entitled to his full remedy for the two cars diverted because simultaneous delivery of all of the cars was not contemplated by either party.

4. Where the circumstances indicate that a party has a right to delivery in lots, the price may be demanded for each lot if it is apportionable.

Cross References:

Point 1: Section 4-1-201.

Point 2: Sections 4-2-508 and 4-2-601.

Point 3: Sections 4-2-503, 4-2-608 and 4-2-609.

Definitional Cross References:

"Contract for sale". Section 4-2-106.

"Goods". Section 4-2-105.

"Lot". Section 4-2-105.

"Party". Section 4-1-201.

"Rights". Section 4-1-201.

ANNOTATION

Parties "otherwise agreed" to delivery terms; therefore the contract obligated the buyer to pay the full amount of the invoice in spite of the fact that the seller had terminated only forty-five percent of the goods. Murray Equipment Co. v. Curtis, Inc., 725 P.2d 35 (Colo. App. 1986).

4-2-308. Absence of specified place for delivery. Unless otherwise agreed:

(a) The place for delivery of goods is the seller's place of business or if he has none his residence; but

(b) In a contract for sale of identified goods which to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery; and

(c) Documents of title may be delivered through customary banking channels.

Source: L. 65: p. 1308, § 1. **C.R.S. 1963:** § 155-2-308.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Paragraphs (a) and (b) — Section 43(1), Uniform Sales Act; Paragraph (c) — none.

Changes: Slight modification in language.

Purposes of Changes and New Matter:

1. Paragraphs (a) and (b) provide for those noncommercial sales and for those occasional commercial sales where no place or means of delivery has been agreed upon by the parties. Where delivery by carrier is "required or authorized by the agreement", the seller's duties as to delivery of the goods are governed not by this section but by Section 2-504.

2. Under paragraph (b) when the identified goods contracted for are known to both parties to be in some location other than the seller's place of business or residence, the parties are presumed to have intended that place to be the place of delivery. This paragraph also applies (unless, as would be normal, the circumstances show that delivery by way of documents is intended) to a bulk of goods in the possession of a bailee. In such a case, however, the seller has the additional obligation to procure the acknowledgment by the bailee of the buyer's right to possession.

3. Where "customary banking channels" call only for due notification by the banker that the documents are on hand, leaving the buyer himself to see to the physical receipt of the goods, tender at the buyer's address is not required under paragraph (c). But that paragraph merely eliminates the possibility of a default by the seller if "customary banking channels" have been properly used in giving notice to the buyer. Where the bank has purchased a draft accompanied by documents or has undertaken its collection on behalf of the seller, Part 5 of Article 4 spells out its duties and relations to its customer. Where the documents move forward under a letter of credit the Article on Letters of Credit spells out the duties and relations between the bank, the seller and the buyer.

4. The rules of this section apply only "unless otherwise agreed." The surrounding circumstances, usage of trade, course of dealing

and course of performance, as well as the express language of the parties, may constitute an "otherwise agreement".

Cross References:

Point 1: Sections 4-2-504 and 4-2-505.

Point 2: Section 4-2-503.

Point 3: Section 4-2-512, Articles 4, Part 5, and 5.

Definitional Cross References:

"Contract for sale". Section 4-2-106.

"Delivery". Section 4-1-201.

"Document of title". Section 4-1-201.

"Goods". Section 4-2-105.

"Party". Section 4-1-201.

"Seller". Section 4-2-103.

4-2-309. Absence of specific time provisions - notice of termination. (1) The time for shipment or delivery or any other action under a contract, if not provided in this article or agreed upon, shall be a reasonable time.

(2) Where the contract provides for successive performances but is indefinite in duration, it is valid for a reasonable time but, unless otherwise agreed, may be terminated at any time by either party.

(3) Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party, and an agreement dispensing with notification is invalid if its operation would be unconscionable.

Source: L. 65: p. 1308, § 1. **C.R.S. 1963:** § 155-2-309.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1) — see Sections 43(2), 45(2), 47(1) and 48, Uniform Sales Act, for policy continued under this Article; Subsection (2) — none; Subsection (3) — none.

Changes: Completely different in scope.

Purposes of Changes and New Matter:

1. Subsection (1) requires that all actions taken under a sales contract must be taken within a reasonable time where no time has been agreed upon. The reasonable time under this provision turns on the criteria as to "reasonable time" and on good faith and commercial standards set forth in Sections 1-203, 1-204 and 2-103. It thus depends upon what constitutes acceptable commercial conduct in view of the nature, purpose and circumstances of the action to be taken. Agreement as to a definite time, however, may be found in a term implied from the contractual circumstances, usage of trade or course of dealing or performance as well as in an express term. Such cases fall outside of this subsection since in them the time for action is "agreed" by usage.

2. The time for payment, where not agreed upon, is related to the time for delivery; the particular problems which arise in connection with determining the appropriate time of payment and the time for any inspection before payment which is both allowed by law and demanded by the buyer are covered in Section 2-513.

3. The facts in regard to shipment and delivery differ so widely as to make detailed provision for them in the text of this Article impracticable. The applicable principles, however, make it clear that surprise is to be avoided, good faith judgment is to be protected, and notice or negotiation to reduce the uncertainty to certainty is to be favored.

4. When the time for delivery is left open, unreasonably early offers of or demands for delivery are intended to be read under this Article as expressions of desire or intention, requesting the assent or acquiescence of the other party, not as final positions which may amount without more to breach or to create breach by the other side. See Sections 2-207 and 2-609.

5. The obligation of good faith under this Act requires reasonable notification before a contract may be treated as breached because a reasonable time for delivery or demand has expired. This operates both in the case of a contract originally indefinite as to time and of one subsequently made indefinite by waiver.

When both parties let an originally reasonable time go by in silence, the course of conduct under the contract may be viewed as enlarging the reasonable time for tender or demand of performance. The contract may be terminated by abandonment.

6. Parties to a contract are not required in giving reasonable notification to fix, at peril of breach, a time which is in fact reasonable in the unforeseeable judgment of a later trier of fact. Effective communication of a proposed time limit calls for a response, so that failure to reply will make out acquiescence. Where objection is made, however, or if the demand is merely for information as to when goods will be delivered or will be ordered out, demand for assurances on the ground of insecurity may be made under this Article pending further negotiations. Only when a party insists on undue delay or on rejection of the other party's reasonable proposal is there a question of flat breach under the present section.

7. Subsection (2) applies a commercially reasonable view to resolve the conflict which has arisen in the cases as to contracts of indefinite duration. The "reasonable time" of duration appropriate to a given arrangement is limited by the circumstances. When the arrangement has been carried on by the parties over the years, the "reasonable time" can continue indefinitely and the contract will not terminate until notice.

8. Subsection (3) recognizes that the application of principles of good faith and sound commercial practice normally call for such notification of the termination of a going contract relationship as will give the other party reasonable time to seek a substitute arrangement. An agreement dispensing with notification or limiting the time for the seeking of a substitute arrangement is, of course, valid under this subsection unless the results of putting it into operation would be the creation of an unconscionable state of affairs.

9. Justifiable cancellation for breach is a remedy for breach and is not the kind of termination covered by the present subsection.

10. The requirement of notification is dispensed with where the contract provides for termination on the happening of an "agreed event." "Event" is a term chosen here to contrast with "option" or the like.

Cross References:

Point 1: Sections 4-1-203, 4-1-204 and 4-2-103.

Point 2: Sections 4-2-320, 4-2-321, 4-2-504, and 4-2-511 through 4-2-514.

Point 5: Section 4-1-203.

Point 6: Section 4-2-609.

Point 7: Section 4-2-204.

Point 9: Sections 4-2-106, 4-2-318, 4-2-610 and 4-2-703.

Definitional Cross References:

"Agreement". Section 4-1-201.

"Contract". Section 4-1-201.

"Notification". Section 4-1-201.

"Party". Section 4-1-201.

"Reasonable time". Section 4-1-204.

"Termination". Section 4-2-106.

ANNOTATION

Where there is a material question of fact as to whether reasonable notice of termination as required by this section was given, the entry of summary judgment was error. William H. White Co. v. B&A Mfg. Co., 794 P.2d 1099 (Colo. App. 1990).

4-2-310. Open time for payment or running of credit - authority to ship under reservation. Unless otherwise agreed:

(a) Payment is due at the time and place at which the buyer is to receive the goods, even though the place of shipment is the place of delivery; and

(b) If the seller is authorized to send the goods, he may ship them under reservation, and may tender the documents of title, but the buyer may inspect the goods after their arrival before payment is due, unless such inspection is inconsistent with the terms of the contract (section 4-2-513); and

(c) If delivery is authorized and made by way of documents of title otherwise than by subsection (b) of this section, then payment is due, regardless of where the goods are to be received, (i) at the time and place at which the buyer is to receive delivery of the tangible documents, or (ii) at the time the buyer is to receive delivery of the electronic documents and at the seller's place of business or, if none, the seller's residence; and

(d) Where the seller is required or authorized to ship the goods on credit, the credit period runs from the time of shipment, but postdating the invoice or delaying its dispatch will correspondingly delay the starting of the credit period.

Source: L. 65: p. 1308, § 1. **C.R.S. 1963:** § 155-2-310. **L. 2006:** (c) amended, p. 491, § 7, effective September 1.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 42 and 47(2), Uniform Sales Act.

Changes: Completely rewritten in this and other sections.

Purposes of Changes: This section is drawn to reflect modern business methods of dealing at a distance rather than face to face. Thus:

1. Paragraph (a) provides that payment is due at the time and place "the buyer is to receive the goods" rather than at the point of delivery

except in documentary shipment cases (paragraph (c)). This grants an opportunity for the exercise by the buyer of his preliminary right to inspection before paying even though under the delivery term the risk of loss may have previously passed to him or the running of the credit period has already started.

2. Paragraph (b) while providing for inspection by the buyer before he pays, protects the seller. He is not required to give up possession of the goods until he has received payment, where no credit has been contemplated by the parties. The seller may collect through a bank by a sight draft against an order bill of lading "hold until arrival; inspection allowed." The obligations of the bank under such a provision are set forth in Part 5 of Article 4. In the absence of a credit term, the seller is permitted to ship under reservation and if he does payment is then due where and when the buyer is to receive the documents.

3. Unless otherwise agreed, the place for the receipt of the documents and payment is the buyer's city but the time for payment is only after arrival of the goods, since under paragraph (b), and Sections 2-512 and 2-513 the buyer is under no duty to pay prior to inspection.

4. Where the mode of shipment is such that goods must be unloaded immediately upon arrival, too rapidly to permit adequate inspection before receipt, the seller must be guided by the provisions of this Article on inspection which provide that if the seller wishes to demand payment before inspection, he must put an appropriate term into the contract. Even requiring payment against documents will not of itself have this desired result if the documents are to be held until the arrival of the goods. But under (b) and (c) if the terms are C.I.F., C.O.D., or cash against documents payment may be due before inspection.

5. Paragraph (d) states the common commercial understanding that an agreed credit period runs from the time of shipment or from that dating of the invoice which is commonly recognized as a representation of the time of shipment. The provision concerning any delay in sending forth the invoice is included because such conduct results in depriving the buyer of his full notice and warning as to when he must be prepared to pay.

Cross References:

Generally: Part 5.

Point 1: Section 4-2-509.

Point 2: Sections 4-2-505, 4-2-511, 4-2-512, 4-2-513 and Article 4.

Point 3: Sections 4-2-308(b), 4-2-512 and 4-2-513.

Point 4: Section 4-2-513(3)(b).

Definitional Cross References:

"Buyer". Section 4-2-103.

"Delivery". Section 4-1-201.

"Document of title". Section 4-1-201.

"Goods". Section 4-2-105.

"Receipt of goods". Section 4-2-103.

"Seller". Section 4-2-103.

"Send". Section 4-1-201.

"Term". Section 4-1-201.

4-2-311. Options and cooperation respecting performance. (1) An agreement for sale which is otherwise sufficiently definite (subsection (3) of section 4-2-204) to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such specification must be made in good faith and within limits set by commercial reasonableness.

(2) Unless otherwise agreed specifications relating to assortment of the goods are at the buyer's option, and except as otherwise provided in subsections (1) (c) and (3) of section 4-2-319, specifications or arrangements relating to shipment are at the seller's option.

(3) Where such specification would materially affect the other party's performance but is not seasonably made, or where one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies:

(a) Is excused for any resulting delay in his own performance; and

(b) May also either proceed to perform in any reasonable manner or after the time for a material part of his own performance treat the failure to specify or to cooperate as a breach by failure to deliver or accept the goods.

Source: L. 65: p. 1309, § 1. **C.R.S. 1963:** § 155-2-311.

Cross references: For the F.O.B. and F.A.S. terms, see § 4-2-319 (1)(c) and (3).

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Subsection (1) permits the parties to leave certain detailed particulars of performance to be filled in by either of them without running the risk of having the contract invalidated for indefiniteness. The party to whom the agreement gives power to specify the missing details is required to exercise good faith and to act in accordance with commercial standards so that there is no surprise and the range of permissible variation is limited by what is commercially reasonable. The "agreement" which permits one party so to specify may be found as well in a course of dealing, usage of trade, or implication from circumstances as in explicit language used by the parties.

2. Options as to assortment of goods or shipping arrangements are specifically reserved to the buyer and seller respectively under subsection (2) where no other arrangement has been made. This section rejects the test which mechanically and without regard to usage or the purpose of the option gave the option to the party "first under a duty to move" and applies instead a standard commercial interpretation to these circumstances. The "unless otherwise agreed" provision of this subsection covers not only express terms but the background and circumstances which enter into the agreement.

3. Subsection (3) applies when the exercise of an option or cooperation by one party is necessary to or materially affects the other party's performance, but it is not seasonably forthcoming; the subsection relieves the other party from the necessity for performance or excuses his delay in performance as the case may be. The contract-keeping party may at his option under this subsection proceed to perform in any commercially reasonable manner rather than wait. In addition to the special remedies provided, this subsection also reserves "all other remedies". The remedy of particular importance in this connection is that provided for insecurity. Request may also be made pursuant to the obligation of good faith for a reasonable indication of the time and manner of performance for which a party is to hold himself ready.

4. The remedy provided in subsection (3) is one which does not operate in the situation which falls within the scope of Section 2-614 on substituted performance. Where the failure to cooperate results from circumstances set forth in that Section, the other party is under a duty to proffer or demand (as the case may be) substitute performance as a condition to claiming rights against the noncooperating party.

Cross References:

Point 1: Sections 4-1-201, 4-2-204 and 4-1-203.

Point 3: Sections 4-1-203 and 4-2-609.

Point 4: Section 4-2-614.

Definitional Cross References:

"Agreement". Section 4-1-201.

"Buyer". Section 4-2-103.

"Contract for sale". Section 4-2-106.

"Goods". Section 4-2-105.

"Party". Section 4-1-201.

"Remedy". Section 4-1-201.

"Seasonably". Section 4-1-204.

"Seller". Section 4-2-103.

4-2-312. Warranty of title and against infringement - buyer's obligation against infringement. (1) Subject to subsection (2) of this section, there is in a contract for sale a warranty by the seller that:

(a) The title conveyed shall be good, and its transfer rightful; and

(b) The goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.

(2) A warranty under subsection (1) of this section will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.

(3) Unless otherwise agreed, a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like, but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

Source: L. 65: p. 1309, § 1. **C.R.S. 1963:** § 155-2-312.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 13, Uniform Sales Act.
Changes: Completely rewritten, the provisions concerning infringement being new.
Purposes of Changes:

1. Subsection (1) makes provision for a buyer's basic needs in respect to a title which he in good faith expects to acquire by his purchase, namely, that he receive a good, clean title transferred to him also in a rightful manner so that he will not be exposed to a lawsuit in order to protect it.

The warranty extends to a buyer whether or not the seller was in possession of the goods at the time the sale or contract to sell was made.

The warranty of quiet possession is abolished. Disturbance of quiet possession, although not mentioned specifically, is one way, among many, in which the breach of the warranty of title may be established.

The "knowledge" referred to in subsection 1(b) is actual knowledge as distinct from notice.

2. The provisions of this Article requiring notification to the seller within a reasonable time after the buyer's discovery of a breach apply to notice of a breach of the warranty of title, where the seller's breach was innocent. However, if the seller's breach was in bad faith he cannot be permitted to claim that he has been misled or prejudiced by the delay in giving notice. In such case the "reasonable" time for notice should receive a very liberal interpretation. Whether the breach by the seller is in good or bad faith Section 2-725 provides that the cause of action accrues when the breach occurs. Under the provisions of that section the breach of the warranty of good title occurs when tender of delivery is made since the warranty is not one which extends to "future performance of the goods."

3. When the goods are part of the seller's normal stock and are sold in his normal course of business, it is his duty to see that no claim of infringement of a patent or trademark by a third party will mar the buyer's title. A sale by a person other than a dealer, however, raises no implication in its circumstances of such a warranty. Nor is there such an implication when the buyer orders goods to be assembled, prepared or manufactured on his own specifications. If, in such a case, the resulting product infringes a patent or trademark, the liability will run from buyer to seller. There is, under such circumstances, a tacit representation on the part of the buyer that the seller will be safe in manufacturing according to the specifications, and the buyer is under an obligation in good faith to indemnify him for any loss suffered.

4. This section rejects the cases which recognize the principle that infringements violate the warranty of title but deny the buyer a remedy unless he has been expressly prevented from using the goods. Under this Article "eviction" is not a necessary condition to the buyer's remedy since the buyer's remedy arises immediately upon receipt of notice of infringement; it is merely one way of establishing the fact of breach.

5. Subsection (2) recognizes that sales by sheriffs, executors, foreclosing lienors and persons similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right. This subsection does not touch upon and leaves open all questions of restitution arising in such cases, when a unique article so sold is reclaimed by a third party as the rightful owner.

6. The warranty of subsection (1) is not designated as an "implied" warranty, and hence is not subject to Section 2-316(3). Disclaimer of the warranty of title is governed instead by subsection (2), which requires either specific language or the described circumstances.

Cross References:

Point 1: Section 4-2-403.
Point 2: Sections 4-2-607 and 4-2-725.
Point 3: Section 4-1-203.
Point 4: Sections 4-2-609 and 4-2-725.
Point 6: Section 4-2-316.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Contract for sale". Section 4-2-106.
"Goods". Section 4-2-105.
"Person". Section 4-1-201.
"Right". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "One Year Review of Contracts", see 38 Dicta 161 (1961).

Annotator's note. Since § 4-2-312 is similar to repealed § 121-1-13, CRS 53, and CSA, C. 143A, § 13 (uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

This section deals with implied warranties of titles. Koscove v. Brunger, 143 Colo. 354, 352 P.2d 961 (1960).

Purchaser may rescind entire transaction although portion has been disposed of. Where a seller of chattels is guilty of a breach of an implied warranty of title and the purchaser re-

lying upon such warranty has sold or disposed of a minor portion of the chattels, the purchaser, upon learning of the defect of title, may elect to rescind the entire transaction. Koscove v. Brunger, 143 Colo. 354, 352 P.2d 961 (1960).

Where one buys produce from a tenant farmer without determining landlord's lien upon such, he does so at his peril. Peterson & Co. v. Novinger, 121 Colo. 171, 214 P.2d 373 (1950).

4-2-313. Express warranties by affirmation, promise, description, sample. (1) Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the seller use formal words such as "warrant" or "guarantee" or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

Source: L. 65: p. 1310, § 1. **C.R.S. 1963:** § 155-2-313.

Cross references: For warranties relating to motor vehicles, see article 10 of title 42.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 12, 14 and 16, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To consolidate and systematize basic principles with the result that:

1. "Express" warranties rest on "dickered" aspects of the individual bargain, and go so clearly to the essence of that bargain that words of disclaimer in a form are repugnant to the basic dickered terms. "Implied" warranties rest so clearly on a common factual situation or set of conditions that no particular language or action is necessary to evidence them and they will arise in such a situation unless unmistakably negated.

This section reverts to the older case law insofar as the warranties of description and sample are designated "express" rather than "implied".

2. Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of this Article are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. They may arise in other appropriate circumstances such as in the case of bailments for hire, whether such bailment is itself the main contract or is merely a supplying of containers under a contract for the sale of their contents. The provisions of Section 2-318 on third party beneficiaries expressly recognize this case law development within one particular area. Beyond that, the matter is left to the case law with the intention that the policies of this Act may offer useful guidance in dealing with further cases as they arise.

3. The present section deals with affirmations of fact by the seller, descriptions of the goods or exhibitions of samples, exactly as any other part of a negotiation which ends in a contract is dealt with. No specific intention to make a warranty is necessary if any of these factors is made part of the basis of the bargain. In actual practice affirmations of fact made by the seller about the goods during a bargain are regarded as part of the description of those goods; hence no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement. Rather, any fact which is to take such affirmations, once made, out of the agreement requires clear affirmative proof. The issue normally is one of fact.

4. In view of the principle that the whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell, the policy is adopted of those cases which refuse except in unusual circumstances to recognize a material deletion of the seller's obligation. Thus, a contract is normally a contract for a sale of something describable and described. A clause generally disclaiming "all warranties, express or implied" cannot reduce the seller's obligation with respect to such description and therefore cannot be given literal effect under Section 2-316.

This is not intended to mean that the parties, if they consciously desire, cannot make their own bargain as they wish. But in determining what they have agreed upon good faith is a factor and consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation.

5. Paragraph (1)(b) makes specific some of the principles set forth above when a description of the goods is given by the seller.

A description need not be by words. Technical specifications, blueprints and the like can afford more exact description than mere language and if made part of the basis of the bargain goods must conform with them. Past deliveries may set the description of quality, either expressly or impliedly by course of dealing. Of course, all descriptions by merchants must be read against the applicable trade usages with the general rules as to merchantability resolving any doubts.

6. The basic situation as to statements affecting the true essence of the bargain is no different when a sample or model is involved in the transaction. This section includes both a "sample" actually drawn from the bulk of goods which is the subject matter of the sale, and a "model" which is offered for inspection when the subject-matter is not at hand and which has not been drawn from the bulk of the goods.

Although the underlying principles are unchanged, the facts are often ambiguous when something is shown as illustrative, rather than as a straight sample. In general, the presumption is that any sample or model just as any affirmation of fact is intended to become a basis of the bargain. But there is no escape from the question of fact. When the seller exhibits a sample purporting to be drawn from an existing bulk, good faith of course requires that the sample be fairly drawn. But in mercantile experience the mere exhibition of a "sample" does not of itself show whether it is merely intended to "suggest" or to "be" the character of the subject-matter of the contract. The question is whether the seller has so acted with reference to the sample as to make him responsible that the whole shall have at least the values shown by it. The circumstances aid in answering this question. If the sample has been drawn from an existing bulk, it must be regarded as describing values of the goods contracted for unless it is accompanied by an unmistakable denial of such responsibility. If, on the other hand, a model of merchandise not on hand is offered, the mercantile presumption that it has become a literal description of the subject matter is not so strong, and particularly so if modification on the buyer's initiative impairs any feature of the model.

7. The precise time when words of description or affirmation are made or samples are shown is not material. The sole question is whether the language or samples or models are fairly to be regarded as part of the contract. If language is used after the closing of the deal (as when the buyer when taking delivery asks and receives an additional assurance), the warranty becomes a modification, and need not be supported by consideration if it is otherwise reasonable and in order (Section 2-209).

8. Concerning affirmations of value or a seller's opinion or commendation under subsection (2), the basic question remains the same: What statements of the seller have in the circumstances and in objective judgment become part of the basis of the bargain? As indicated above, all of the statements of the seller do so unless good reason is shown to the contrary. The provisions of subsection (2) are included, however, since common experience discloses that some statements or predictions cannot fairly be viewed as entering into the bargain. Even as to false statements of value, however, the possibility is left open that a remedy may be provided by the law relating to fraud or misrepresentation.

Cross References:

Point 1: Section 4-2-316.
Point 2: Sections 1-102(3) and 4-2-318.
Point 3: Section 4-2-316(2)(b).
Point 4: Section 4-2-316.
Point 5: Sections 4-1-205(4) and 4-2-314.
Point 6: Section 4-2-316.
Point 7: Section 4-2-209.
Point 8: Section 4-1-103.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Conforming". Section 4-2-106.
"Goods". Section 4-2-105.
"Seller". Section 4-2-103.

ANNOTATION

I. GENERAL CONSIDERATION.

Law reviews. For article, "One Year Review of Contracts", see 34 Dicta 85 (1957). For note, "Privity of Contract and the Breach of Warranty Action", see 35 U. Colo. L. Rev. 232 (1963).

The several types of warranties coexist. Westric Battery Co. v. Standard Elec. Co., 482 F.2d 1307 (10th Cir. 1973).

Lessee as third party beneficiary to warranties. Although a lessee of a machine does not directly receive the benefits of the warranties made by the seller to the lessor, the lessee may

be a third party beneficiary of such warranties who could "reasonably be expected to use, consume, or be affected by the goods". Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

Warranty's existence or breach for trier of fact. The question of the existence of a warranty and whether that warranty was breached is ordinarily one for the trier of fact. Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975); Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984).

Warranty applicable to heating system which was moved into buyers' residence for installation and later removed. Thomas v. Bove, 687 P.2d 534 (Colo. App. 1984).

Cause of action generally accrues at purchase. Normally, a cause of action for the breach of an express warranty accrues at the time of the purchase of the goods. Glen Peck, Ltd. v. Fritsche, 651 P.2d 414 (Colo. App. 1981).

Express warranty may explicitly extend to future performance. Glen Peck, Ltd. v. Fritsche, 651 P.2d 414 (Colo. App. 1981).

Unreasonable use most common defense. The most common accepted affirmative defense to a warranty claim is unreasonable use of the product by the plaintiff with knowledge of the defective condition and the risk it creates. This defense bears a resemblance to the negligence doctrine of assumption of risk. Hensley v. Sherman Car Wash Equip. Co., 33 Colo. App. 279, 520 P.2d 146 (1974).

For discussion of the distinction between liability in contract for breach of warranty and strict tort liability for product misrepresentation, see Am. Safety Equip. Corp. v. Winkler, 640 P.2d 216 (Colo. 1982).

Contributory negligence not defense. The concept of contributory negligence, as it is known in negligence case law and as distinct from the doctrine of assumption of risk, has no place in actions premised on breach of warranty. Hensley v. Sherman Car Wash Equip. Co., 33 Colo. App. 279, 520 P.2d 146 (1974).

Applied in Caldwell v. Kats, 38 Colo. App. 156, 555 P.2d 190 (1976); Hummel v. Skyline Dodge, Inc., 41 Colo. App. 572, 589 P.2d 73 (1978); Shaw v. General Motors Corp., 727 P.2d 387 (Colo. App. 1986).

II. EXPRESS WARRANTIES.

A. Affirmation or Promise.

Annotator's note. Since § 4-2-313(1)(a) is similar to repealed § 121-1-12, C.R.S. 1963, and § 121-1-12, CRS 53 (uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

Evidence sufficient for submission of instruction to jury. Evidence pertaining to manufacturer's brochure which was considered by plaintiff in connection with the purchase of a bumper jack was sufficient to warrant submission of an instruction on express warranty to the jury. Kinard v. Coats Co., 37 Colo. App. 555, 553 P.2d 835 (1976).

Evidence pertaining to statements contained in literature printed by the manufacturer of an intrauterine device and statements by the manufacturer's representatives which were considered by the plaintiff and her physician in making the decision to use the product was sufficient to warrant submission of an instruction on express warranty to the jury. Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984).

Ample evidence to allow claim for breach of express warranty to go to the jury where tags attached to fuel controls indicated that the controls were inspected and accepted in accordance with original manufacturer's latest methods procedures and specifications and the certificate of conformance accompanying the fuel controls stated that the controls were "as is tested/repaired to the original equipment manufacturer's specification requirements" and uncontested testimony at trial indicated that the fuel controls did not function properly at altitudes well below those called for in the internal specifications. Pegasus Helicopters, Inc. v. United Technologies Corp., 35 F.3d 507 (10th Cir. 1994).

An express warranty may be inferred from an affirmation of a fact or a promise by the seller which induces the purchase, on which the buyer relies, and on which the seller intended that he should so do. Duncan v. Bd. of County Comm'rs, 154 Colo. 447, 391 P.2d 368 (1964).

An averment at the time of the sale is a warranty provided the jury finds from the evidence on the trial it was so intended. Such intention may be reached as an inference or deduction from the facts or circumstances in connection with all the evidence on the trial, and when such deduction is made, if it rests upon proper and sufficient evidence, it becomes proof as a fact of warranty. Rudd v. Rogerson, 133 Colo. 506, 297 P.2d 533 (1956).

There can be no operative warranty unless it be affirmatively shown that the buyer relied on the affirmation of fact or promise of the seller. The affirmation asserted as a warranty must have been operative in causing the sale and must have been understood by the buyer as being intended as part of the contract. It need not, however, have been the sole inducement to the purchase, nor need the buyer actually have been deceived by the statement. Only such reliance is required as is necessary in contracts generally, and where a representation has entered into the contract as an intended element thereof and as a part of the consideration, the requirement that it be an inducement in order to be operative as a warranty is fully satisfied.

Duncan v. Bd. of County Comm'rs, 154 Colo. 447, 391 P.2d 368 (1964).

There is no duty on the buyer of goods who purchases with an express warranty to inspect the article purchased, or to exercise care in discovering any defects, or to investigate the truth of the seller's statements; rather, he may rely on the contract of the seller for the delivery of goods which satisfy the warranty, except that the contract may expressly provide for an inspection or test to be made by the purchaser as a condition. Rudd v. Rogerson, 133 Colo. 506, 297 P.2d 533 (1956).

The maxim "caveat emptor" has no application to matters included in an express warranty, and even where the buyer has an equal opportunity with the seller to form his own judgment as to the character and condition of the property he may receive and rely on a warranty instead; opportunity on the part of the buyer to inspect does not militate against the availability of an express warranty in the sale. Rudd v. Rogerson, 133 Colo. 506, 297 P.2d 533 (1956).

Where an expressed warranty is given, the buyer is not precluded from relying upon it, unless his investigation reveals the defect. Rudd v. Rogerson, 133 Colo. 506, 297 P.2d 533 (1956).

Even though the buyer makes an inspection the warranty is not rendered inoperative unless the buyer is clearly relying upon his own investigation and waives the warranty; investigation is compatible with the giving of an express warranty. Rudd v. Rogerson, 133 Colo. 506, 297 P.2d 533 (1956); Norton v. Lindsay, 350 F.2d 46 (10th Cir. 1965).

Writing does not exclude undertaking by seller. Where a letter addressed to the buyer and signed by the seller described a machine, but did not include a provision as to its ability to produce, then, nevertheless, where it appeared that there were numerous conversations between the parties and that the buyer fully explained to the seller the machine was to be used on a mass production basis and its intricacies were also made known to the seller from the beginning, it cannot be said that the writing excluded undertakings by the seller in the light of the buyer's requirements that the seller produce a machine which would fulfill specific needs. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

Testimony that the seller specifically "guaranteed" or "promised" that an article would work satisfactorily and that it was clearly understood by all that the seller would get paid if, and only if, the article functioned properly clearly supported the finding of an express warranty. Duncan v. Bd. of County Comm'rs, 154 Colo. 447, 391 P.2d 368 (1964).

The word "sound" when used with reference to many animals and especially a horse has a special and particular connotation. The statement that a horse is "sound" implies "the absence of any defect or disease which will impair the animal's natural usefulness for the purpose for which it is purchased." Norton v. Lindsay, 350 F.2d 46 (10th Cir. 1965).

An express warranty by a sales agent imposes liability on the salesman, but not the manufacturer, where the terms of the warranty as to safety exceeded the agent's authority. Senter v. B.F. Goodrich Co., 127 F. Supp. 705 (D. Colo. 1954).

No express warranty was created by language in automobile manufacturer's publication which was merely the seller's opinion of the goods rather than an affirmation of fact or promise. Shaw v. General Motors Corp., 727 P.2d 387 (Colo. App. 1986).

No form of disclaimer will be allowed a seller to disclaim the known true nature of an item to be sold. Olson Mfg. Co. v. Roberts, 131 Colo. 152, 280 P.2d 433 (1955).

B. Description.

Annotator's note. Since § 4-2-313(1)(b) is similar to repealed § 121-1-14, C.R.S. 1963, and CSA, C. 143A, § 14 (uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

Where an order is in writing and describes the goods, it is clear that the parties consummated a "sale of goods by description", as those words are used in this section. Lindsey v. Stalder, 120 Colo. 58, 208 P.2d 83 (1949).

But where one orders a product and directs that the character thereof be changed before delivery, but no one can say whether the shipment was properly sent as initially described, then there is no evidence to support a judgment under this section. Lindsey v. Stalder, 120 Colo. 58, 208 P.2d 83 (1949).

Applied in Eggen v. M. & K. Trailers & Mobile Home Brokers, Inc., 29 Colo. App. 177, 482 P.2d 435 (1971); Universal Drilling Co. v. Camay Drilling Co., 737 F.2d 869 (10th Cir. 1984).

C. Sample.

No sale by sample where buyer does not rely on seller. Where the seller exhibited a small sample of a finished product, stating "here is what it looks like", and the buyer orders rough product in reliance on its own employees' evaluation, the sale was not a sale by sample carrying the warranty that the bulk should correspond to the sample. Lindsey v. Stalder, 120 Colo. 58, 208 P.2d 83 (1949) (decided under repealed CSA, C. 143A, § 16, uniform sales act).

III. FORMAL WORDS NOT NECESSARY.

Annotator's note. Since § 4-2-313(2) is similar to repealed § 121-1-12, C.R.S. 1963,

and § 121-1-12, CRS 53 (uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

An express warranty need not be in any particular form. Rudd v. Rogerson, 133 Colo. 506, 297 P.2d 533 (1956); Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

No special form of words is necessary to create a warranty. Rudd v. Rogerson, 133 Colo. 506, 297 P.2d 533 (1956); Norton v. Lindsay, 350 F.2d 46 (10th Cir. 1965).

To constitute an express warranty the term "warrant" need not be used, as no technical set of words is required. Duncan v. Bd. of County Comm'rs, 154 Colo. 447, 391 P.2d 368 (1964).

Warranties not confined to affirmations in written agreements. Express warranties are not confined only to affirmations of fact contained in the written agreement between the parties. Colorado-Ute Elec. Ass'n v. Envirotech Corp., 524 F. Supp. 1152 (D. Colo. 1981).

Promotional literature and correspondence are part of basic bargain. Express warranties made by the seller in promotional literature and correspondence sent to the buyer before a sale was made are part of the basic bargain between buyer and seller. Colorado-Ute Elec. Ass'n v. Envirotech Corp., 524 F. Supp. 1152 (D. Colo. 1981); Lutz Farm v. Asgrow Seed Co., 948 F.2d (10th Cir. 1991).

Corporation's dissemination of information qualified as warranties. Where a corporation disseminated information using advertising materials, trade publications, or technical publications and oral statements representing the quality of its product, this activity qualifies in law as warranties. Westric Battery Co. v. Standard Elec. Co., 482 F.2d 1307 (10th Cir. 1973).

Unnecessary to prove scienter. At common law, in an action for breach of an express warranty, it was unnecessary to allege or prove a scienter, and the uniform commercial code does not change this rule. Kensair Corp. v. Peltier, 28 Colo. App. 290, 472 P.2d 700 (1970).

Good faith and lack of knowledge do not constitute defenses. Where there is a breach of an express warranty, neither the fact that the seller acted in good faith nor the fact that the seller made the warranty without knowledge of its falsity constitute a defense. Kensair Corp. v. Peltier, 28 Colo. App. 290, 472 P.2d 700 (1970).

No particular reliance by buyer on affirmation of goods must be shown before such statement made by seller is considered an express warranty. Lutz Farms v. Asgrow Seed Co., 948 F.2d (10th Cir. 1991).

4-2-314. Implied warranty - merchantability - usage of trade. (1) Unless excluded or modified (section 4-2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section, the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as:

(a) Pass without objection in the trade under the contract description; and

(b) In the case of fungible goods, are of fair average quality within the description; and

(c) Are fit for the ordinary purposes for which such goods are used; and

(d) Run, within the variations permitted by the agreement, of even kind, quality, and quantity within each unit and among all units involved; and

(e) Are adequately contained, packaged, and labeled as the agreement may require; and

(f) Conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (section 4-2-316), other implied warranties may arise from course of dealing or usage of trade.

Source: L. 65: p. 1310, § 1. **C.R.S. 1963:** § 155-2-314.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 15(2), Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes: This section, drawn in view of the steadily developing case law on the subject, is intended to make it clear that:

1. The seller's obligation applies to present sales as well as to contracts to sell subject to the effects of any examination of specific goods. (Subsection (2) of Section 2-316). Also, the warranty of merchantability applies to sales for use as well as to sales for resale.

2. The question when the warranty is imposed turns basically on the meaning of the terms of the agreement as recognized in the trade. Goods delivered under an agreement made by a merchant in a given line of trade must be of a quality comparable to that generally acceptable in that line of trade under the description or other designation of the goods used in the

agreement. The responsibility imposed rests on any merchant-seller, and the absence of the words "grower or manufacturer or not" which appeared in Section 15(2) of the Uniform Sales Act does not restrict the applicability of this section.

3. A specific designation of goods by the buyer does not exclude the seller's obligation that they be fit for the general purposes appropriate to such goods. A contract for the sale of second-hand goods, however, involves only such obligation as is appropriate to such goods for that is their contract description. A person making an isolated sale of goods is not a "merchant" within the meaning of the full scope of this section and, thus, no warranty of merchantability would apply. His knowledge of any defects not apparent on inspection would, however, without need for express agreement and in keeping with the underlying reason of the present section and the provisions on good faith, impose an obligation that known material but hidden defects be fully disclosed.

4. Although a seller may not be a "merchant" as to the goods in question, if he states generally that they are "guaranteed" the provisions of this section may furnish a guide to the content of the resulting express warranty. This has particular significance in the case of second-hand sales, and has further significance in limiting the effect of fine-print disclaimer clauses where their effect would be inconsistent with large-print assertions of "guarantee".

5. The second sentence of subsection (1) covers the warranty with respect to food and drink. Serving food or drink for value is a sale, whether to be consumed on the premises or elsewhere. Cases to the contrary are rejected. The principal warranty is that stated in subsections (1) and (2)(c) of this section.

6. Subsection (2) does not purport to exhaust the meaning of "merchantable" nor to negate any of its attributes not specifically mentioned in the text of the statute, but arising by usage of trade or through case law. The language used is "must be at least such as ...," and the intention is to leave open other possible attributes of merchantability.

7. Paragraphs (a) and (b) of subsection (2) are to be read together. Both refer, as indicated above, to the standards of that line of the trade which fits the transaction and the seller's business. "Fair average" is a term directly appropriate to agricultural bulk products and means goods centering around the middle belt of quality, not the least or the worst that can be understood in the particular trade by the designation, but such as can pass "without objection." Of course a fair percentage of the least is permissible but the goods are not "fair average" if they are all of the least or worst quality possible under the description. In cases of doubt as to what quality is intended, the price at which a merchant closes a contract is an excellent index of the nature and scope of his obligation under the present section.

8. Fitness for the ordinary purposes for which goods of the type are used is a fundamental concept of the present section and is covered in paragraph (c). As stated above, merchantability is also a part of the obligation owing to the purchaser for use. Correspondingly, protection, under this aspect of the warranty, of the person buying for resale to the ultimate consumer is equally necessary, and merchantable goods must therefore be "honestly" resalable in the normal course of business because they are what they purport to be.

9. Paragraph (d) on evenness of kind, quality and quantity follows case law. But precautionary language has been added as a remainder of the frequent usages of trade which permit substantial variations both with and without an allowance or an obligation to replace the varying units.

10. Paragraph (e) applies only where the nature of the goods and of the transaction require a certain type of container, package or label. Paragraph (f) applies, on the other hand, wherever there is a label or container on which representations are made, even though the original contract, either by express terms or usage of trade, may not have required either the labelling or the representation. This follows from the general obligation of good faith which requires that a buyer should not be placed in the position of reselling or using goods delivered under false representations appearing on the package or container. No problem of extra consideration arises in this connection since, under this Article, an obligation is imposed by the original contract not to deliver mislabeled articles, and the obligation is imposed where mercantile good faith so requires and without reference to the doctrine of consideration.

11. Exclusion or modification of the warranty of merchantability, or of any part of it, is dealt with in the section to which the text of the present section makes explicit precautionary references. That section must be read with particular reference to its subsection (4) on limitation of remedies. The warranty of merchantability, wherever it is normal, is so commonly taken for granted that its exclusion from the contract is a matter threatening surprise and therefore requiring special precaution.

12. Subsection (3) is to make explicit that usage of trade and course of dealing can create warranties and that they are implied rather than express warranties and thus subject to exclusion or modification under Section 2-316. A typical instance would be the obligation to provide pedigree papers to evidence conformity of the animal to the contract in the case of a pedigreed dog or blooded bull.

13. In an action based on breach of warranty, it is of course necessary to show not only the existence of the warranty but the fact that the warranty was broken and that the breach of the warranty was the proximate cause of the loss sustained. In such an action an affirmative showing by the seller that the loss resulted from some action or event following his own delivery of the goods can operate as a defense. Equally, evidence indicating that the seller exercised care in the manufacture, processing or selection of the goods is relevant to the issue of whether the warranty was in fact broken. Action by the buyer following an examination of the goods which ought to have indicated the defect complained of can be shown as matter bearing on whether the breach itself was the cause of the injury.

Cross References:

Point 1: Section 4-2-316.
Point 3: Sections 4-1-203 and 4-2-104.
Point 5: Section 4-2-315.
Point 11: Section 4-2-316.
Point 12: Sections 4-1-201, 4-1-205 and 4-2-316.

Definitional Cross References:

"Agreement". Section 4-1-201.
"Contract". Section 4-1-201.
"Contract for sale". Section 4-2-106.
"Goods". Section 4-2-105.
"Merchant". Section 4-2-104.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "The Uniform Commercial Code and Sales Warranties in Colorado", see 38 U. Colo. L. Rev. 7 (1965). For note, "Implied Warranty of Fitness for Habitation in Sale of Residential Dwellings", see 43 Den. L. J. 379 (1966). For note, "Implied Warranties — Sales of Used Cars in Colorado", see 42 U. Colo. L. Rev. 473 (1971). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "The Enterprise Liability Theory of Torts", see 47 U. Colo. L. Rev. 153 (1976). For comment, "Implied Warranties in the Sale of Real Estate in Colorado: Rational Boundaries of the Doctrine", see 53 U. Colo. L. Rev. 137 (1981). For article, "Let the Builder-Vendor Beware: The Demise of Caveat Emptor in Colorado — Part I", see 16 Colo. Law. 463 (1987). For article, "Let the Builder-Vendor Beware: Defenses and Damages in Home Builder Litigation — Part II", see 16 Colo. Law. 629 (1987).

Annotator's note. Since § 4-2-314 is similar to repealed § 121-1-15(1)(c), C.R.S. 1963, § 121-1-15(2), CRS 53, and CSA, C. 143A, § 15(2) (uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

The several types of warranties coexist. Westric Battery Co. v. Standard Elec. Co., 482 F.2d 1307 (10th Cir. 1973).

Implied warranties of merchantability and fitness for a particular purpose may coexist when there is sufficient evidence to support the creation of each warranty. Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984); Hawkinson v. A.H. Robins Co., Inc., 595 F. Supp. 1290 (D. Colo. 1984).

Evidence that woman selected intrauterine device not only for the ordinary purpose of preventing pregnancy, but also for the particular purpose of providing her with a safe contraceptive device was sufficient to justify submission to the jury of the dual implied warranties of fitness for a particular purpose and merchantability. Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984).

Doctrine of strict liability adopted where design renders unreasonably dangerous an otherwise properly manufactured product. Pust v. Union Supply Co., 38 Colo. App. 435, 561 P.2d 355 (1976), rev'd sub nom. Holly Sugar Corp. v. Union Supply Co., 194 Colo. 316, 572 P.2d 148 (1977) (third party indemnification issue), and aff'd, 196 Colo. 162, 583 P.2d 276 (1978).

Design enhances extent of injuries. Strict liability attaches to an automobile design defect which, though not contributing to the collision itself, may have enhanced the injuries sustained. Roberts v. May, 41 Colo. App. 82, 583 P.2d 305 (1978).

Defect in design may render product unmerchantable or not fit for the particular purposes for which it was required. Union Supply Co. v. Pust, 196 Colo. 162, 583 P.2d 276 (1978).

For effect on manufacturer's liability where product is unavoidably unsafe, see Belle Bonfils Mem. Blood Bank v. Hansen, 665 P.2d 118 (Colo. 1983).

Summary judgment improper where factual question as to reasonableness of design. Where plaintiff's experts raise a factual question about the reasonableness of defendant's design strategies, the drastic remedy of summary judgment is improper, and the issue of whether the design of the car unreasonably increased the risks of injury by collision should be presented to the jury. Roberts v. May, 41 Colo. App. 82, 583 P.2d 305 (1978).

A dealer who sells articles which ordinarily are used in but one way impliedly warrants fitness for use in that particular way, unless there is evidence to the contrary, and this is a

warrant of merchantability. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

Contract required to involve sale of product. A claim asserting a breach of the "implied warranty of merchantability and fitness" under this section required that the contract in question involve the sale of a product. Strong v. Retail Credit Co., 38 Colo. App. 125, 552 P.2d 1025 (1976).

Concepts of liability without fault are not applicable to service contracts. Strong v. Retail Credit Co., 38 Colo. App. 125, 552 P.2d 1025 (1976).

Warranties arise in every contract for sale unless excluded. Warranties of merchantability and of fitness for a particular purpose, assuming all other statutory prerequisites have been met, arise in every contract for sale, unless properly excluded. Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

A seller in connection with a sale of goods who incidentally renders services in the installation of those goods, knows the use and purpose intended for the goods, and knows that the user is relying on his skill and judgment in connection with the sale is liable under the theory of implied warranty of merchantability for each and every step of the process under his control by which the goods are transferred to the ultimate user, including any services rendered. Bailey v. Montgomery Ward & Co., Inc., 690 P.2d 1280 (Colo. App. 1984).

Where contract provides for sale of goods and for performance of labor or service, test under this section is whether the circumstances underlying the formation of the agreement and the performance reasonably expected demonstrate that the primary purpose of the contract is either the sale of goods or the sale of labor or service. Factors to be considered include: 1) The contractual language; 2) whether an overall price is charged, or the goods and labor are separately billed; 3) the ratio of the cost of goods to the overall contract price; and 4) the nature and reasonableness of the purchaser's expectations of acquiring a property interest in the goods. Bailey v. Montgomery Ward & Co., Inc., 690 P.2d 1280 (Colo. App. 1984).

Warranty applicable to heating system which was moved into buyers' residence for installation and later removed. Thomas v. Bove, 687 P.2d 534 (Colo. App. 1984).

Transfusion of blood was not sale of product. St. Luke's Hosp. v. Schmaltz, 188 Colo. 353, 534 P.2d 781 (1975).

Implied warranty liability extended to component parts manufacturer. As in the area of strict liability, implied warranty liability may extend to the manufacturer of component parts if the lack of fitness for the purpose or use required is found in the component parts before they leave the component parts manufacturer, and not merely in the completed system. Union Supply Co. v. Pust, 196 Colo. 162, 583 P.2d 276 (1978); Shaw v. General Motors Corp., 727 P.2d 387 (Colo. App. 1986).

Corporation's dissemination of information qualified as warranties. Where a corporation disseminated information using advertising materials, trade publications, or technical publications and oral statements representing the quality of its product, this activity qualifies in law as warranties. Westric Battery Co. v. Standard Elec. Co., 482 F.2d 1307 (10th Cir. 1973).

Admission of industry safety codes as substantive evidence on strict liability issue of whether a product is in a defective condition unreasonably dangerous is valid. Union Supply Co. v. Pust, 196 Colo. 162, 583 P.2d 276 (1978).

Evidence of industry safety standards, when relevant as to a defect, must be introduced through an expert, must be authenticated as reliable and bona fide industry-wide safety codes, and sufficient advance notice of the intended use of such standards must be given to the adverse party so that he will have sufficient time to prepare to meet the evidence. Union Supply Co. v. Pust, 196 Colo. 162, 583 P.2d 276 (1978).

Fertilizer containing herbicides was neither fit for its ordinary purpose nor for the farmers particular purpose, and therefore, breaches both the implied warranty of fitness and the implied warranty of merchantability. Deacon v. Am. Plant Food Corp., 782 P.2d 861 (Colo. App. 1989), rev'd on other grounds sub nom. Stone's Farm Supply, Inc. v. Deacon, 805 P.2d 1109 (Colo. 1991).

Lessee as third party beneficiary of warranties. Although a lessee of a machine does not directly receive the benefits of the warranties made by the seller to the lessor, the lessee may be a third party beneficiary of such warranties who could "reasonably be expected to use, consume, or be affected by the goods". Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

One who sells an article for use as food for human consumption is held to have impliedly warranted that it is fit for the purpose for which it was sold, and for breach of that warranty proximately resulting in injury, may be held to respond in damages. Gonzales v. Safeway Stores, Inc., 147 Colo. 358, 363 P.2d 667 (1961).

Aside from the statute, a retailer who sells unwholesome food for human consumption is liable to the customer for the consequences under an implied warranty imposed by law as a matter of public policy, even though the food is in sealed containers bearing the label of the manufacturer and the retailer has no means of knowing that the contents are unfit for human consumption. Gonzales v. Safeway Stores, Inc., 147 Colo. 358, 363 P.2d 667 (1961).

Where an advertisement does not mention the name of the product and the buyer does not see a label or other evidence of the name of the product before using it, but relies on the seller's judgment and skill to supply him with a sufficient and safe product, there is an implied warranty that the product is of merchantable quality, permitting recovery of actual damages sustained. Huscher v. Pfost, 122 Colo. 301, 221 P.2d 931 (1950). See Gonzales v. Safeway Stores, Inc., 147 Colo. 358, 363 P.2d 667 (1961).

Warranties will be implied in a house purchased in the course of construction that it is built in an efficient and workmanlike manner and of proper materials and when finished will be fit for habitation. Carpenter v. Donohoe, 154 Colo. 78, 388 P.2d 399 (1964).

Implied warranties include completed buildings. The implied warranty doctrine includes agreements between builder-vendors and purchasers for the sale of newly constructed buildings, completed at the time of contracting. There is an implied warranty that builder-vendors have complied with the building code of the area in which the structure is located, and where a home is the subject of sale, there are implied warranties that the home was built in workmanlike manner and is suitable for habitation. Carpenter v. Donohoe, 154 Colo. 78, 388 P.2d 399 (1964).

Implied warranty extends to a buyer who incurs injury through an allergic reaction to a product where such an individual is a member of an identifiable class of persons allergic thereto. Howard v. Avon Prods., Inc., 155 Colo. 444, 395 P.2d 1007 (1964).

The buyer has the burden of establishing that the product is injurious to a "significant number" of the population. Howard v. Avon Prods., Inc., 155 Colo. 444, 395 P.2d 1007(1964).

One fails to bring himself within the identifiable class or significant number concept when at the time of purchase, at which point the implied warranty attaches, there is no reasonably foreseeable class of potential users who could be described as prone to suffer from an allergic reaction. Howard v. Avon Prods., Inc., 155 Colo. 444, 395 P.2d 1007 (1964).

Sellers who failed to provide purchase documentation for liquor inventory to buyers of inn breached implied warranty of merchantability entitling buyers to reject undocumented portion of liquor inventory. Purpose of this section is to allocate to seller the risk of loss stemming from defects that render goods unmerchantable. Loden v. Drake, 881 P.2d 467 (Colo. App. 1994).

Plaintiff must prove injuries proximately caused. It is incumbent upon the plaintiff in an action for breach of an implied warranty of fitness to prove that the injuries were proximately caused by the breach of such warranty. Dallison v. Sears, Roebuck & Co., 313 F.2d 343 (10th Cir. 1962).

Negligence is a defense to an action for breach of such an implied warranty. Dallison v. Sears, Roebuck & Co., 313 F.2d 343 (10th Cir. 1962).

Applied in Eggen v. M. & K. Trailers & Mobile Home Brokers, Inc., 29 Colo. App. 177, 482 P.2d 435 (1971); Pust v. Union Supply Co., 38 Colo. App. 435, 561 P.2d 355 (1976); Colorado-Ute Elec. Ass'n v. Envirotech Corp., 524 F. Supp. 1152 (D. Colo. 1981); White v. Mississippi Order Buyers, Inc., 648 P.2d 682 (Colo. App. 1982).

4-2-315. Implied warranty - fitness for particular purpose. Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is, unless excluded or modified under section 4-2-316, an implied warranty that the goods shall be fit for such purpose.

Source: L. 65: p. 1311, § 1. **C.R.S. 1963:** § 155-2-315.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 15(1), (4), (5), Uniform Sales Act.
Changes: Rewritten.
Purposes of Changes:

1. Whether or not this warranty arises in any individual case is basically a question of fact to be determined by the circumstances of the contracting. Under this section the buyer need not bring home to the seller actual knowledge of the particular purpose for which the goods are intended or of his reliance on the seller's skill and judgment, if the circumstances are such that the seller has reason to realize the purpose intended or that the reliance exists. The buyer, of course, must actually be relying on the seller.

2. A "particular purpose" differs from the ordinary purpose for which the goods are used in that it envisages a specific use by the buyer which is peculiar to the nature of his business whereas the ordinary purposes for which goods are used are those envisaged in the concept of merchantability and go to uses which are customarily made of the goods in question. For example, shoes are generally used for the pur-

pose of walking upon ordinary ground, but a seller may know that a particular pair was selected to be used for climbing mountains.

A contract may of course include both a warranty of merchantability and one of fitness for a particular purpose.

The provisions of this Article on the cumulation and conflict of express and implied warranties must be considered on the question of inconsistency between or among warranties. In such a case any question of fact as to which warranty was intended by the parties to apply must be resolved in favor of the warranty of fitness for particular purpose as against all other warranties except where the buyer has taken upon himself the responsibility of furnishing the technical specifications.

3. In connection with the warranty of fitness for a particular purpose the provisions of this Article on the allocation or division of risks are particularly applicable in any transaction in which the purpose for which the goods are to be used combines requirements both as to the quality of the goods themselves and compliance with certain laws or regulations. How the risks are divided is a question of fact to be determined, where not expressly contained in the agreement, from the circumstances of contracting, usage of trade, course of performance and the like, matters which may constitute the "otherwise agreement" of the parties by which they may divide the risk or burden.

4. The absence from this section of the language used in the Uniform Sales Act in referring to the seller, "whether he be the grower or manufacturer or not," is not intended to impose any requirement that the seller be a grower or manufacturer. Although normally the warranty will arise only where the seller is a merchant with the appropriate "skill or judgment," it can arise as to non-merchants where this is justified by the particular circumstances.

5. The elimination of the "patent or other trade name" exception constitutes the major extension of the warranty of fitness which has been made by the cases and continued in this Article. Under the present section the existence of a patent or other trade name and the designation of the article by that name, or indeed in any other definite manner, is only one of the facts to be considered on the question of whether the buyer actually relied on the seller, but it is not of itself decisive of the issue. If the buyer himself is insisting on a particular brand he is not relying on the seller's skill and judgment and so no warranty results. But the mere fact that the article purchased has a particular patent or trade name is not sufficient to indicate nonreliance if the article has been recommended by the seller as adequate for the buyer's purposes.

6. The specific reference forward in the present section to the following section on exclusion or modification of warranties is to call attention to the possibility of eliminating the warranty in any given case. However it must be noted that under the following section the warranty of fitness for a particular purpose must be excluded or modified by a conspicuous writing.

Cross References:

Point 2: Sections 4-2-314 and 4-2-317.
Point 3: Section 4-2-303.
Point 6: Section 4-2-316.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Goods". Section 4-2-105.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "The Uniform Commercial Code and Sales Warranties in Colorado", see 38 U. Colo. L. Rev. 7 (1965). For note, "Implied Warranties — Sales of Used Cars in Colorado", see 42 U. Colo. L. Rev. 473 (1971). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 33 (1974-75). For comment, "Implied Warranties in the Sale of Real Estate in Colorado: Rational Boundaries of the Doctrine", see 53 U. Colo. L. Rev. 137 (1981).

Annotator's note. Since § 4-2-315 is similar to repealed § 121-1-15(1)(b), (3), and (4), C.R.S. 1963, § 121-1-15(1), (4), and (5), CRS 53, and CSA, C. 143A, § 15(1), (4), and (5)(uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

This section provides for an implied warranty that the goods be reasonably fit for the uses, made known to the seller by the buyer, for which they were purchased. Wallower v. Elder, 126 Colo. 109, 247 P.2d 682 (1952).

This section includes cases for which an implied warranty hinges on the question of whether or not the buyer makes known to the seller the uses for which he desires the chattels. Wallower v. Elder, 126 Colo. 109, 247 P.2d 682 (1952).

Expressly or by implication. There is no implied warranty of fitness for any particular purpose unless the buyer expressly or by implication makes known to the seller the particular purpose for which the goods are required. Schlottman v. Pressey, 96 F. Supp. 979 (D. Colo. 1951); Schlottman v. Pressey, 195 F.2d 343 (10th Cir. 1952); Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

General or specific purpose. The buyer's particular purpose may be equivalent to nothing more than a general purpose or it may relate to a more specific purpose. Comet Indus., Inc. v.

Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

Under this section the buyer's reliance on the seller's skill or judgment must be shown before an implied warranty of fitness of purpose can arise. Wallower v. Elder, 126 Colo. 109, 247 P.2d 682 (1952); Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963); Klipfel v. Neill, 30 Colo. App. 428, 494 P.2d 115. (1972).

Actual reliance is required; affidavit alleging that a purchaser would have relied on the seller had the seller advised her the product was unsuitable does not create a genuine issue of material fact when the purchaser testified that she decided to buy the product before entering the seller's store. Wallman v. Kelley, 976 P.2d 330 (Colo. App. 1998).

The several types of warranties coexist. Westric Battery Co. v. Standard Elec. Co., 482 F.2d 1307 (10th Cir. 1973).

Implied warranties of merchantability and fitness for a particular purpose may coexist when there is sufficient evidence to support the creation of each warranty. Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984); Hawkinson v. A.H. Robins Co., Inc., 595 F. Supp. 1290 (D. Colo. 1984).

Evidence that woman selected intrauterine device not only for the ordinary purpose of preventing pregnancy, but also for the particular purpose of providing her with a safe contraceptive device was sufficient to justify submission to the jury of the dual implied warranties of fitness for a particular purpose and merchantability. Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984).

Doctrine of strict liability adopted where design renders unreasonably dangerous an otherwise properly manufactured product. Pust v. Union Supply Co., 38 Colo. App. 435, 561 P.2d 355 (1976), rev'd sub nom. Holly Sugar Corp. v. Union Supply Co., 194 Colo. 316, 572 P.2d 148 (1977) (party indemnification issue), and aff'd, 196 Colo. 162, 583 P.2d 276 (1978).

Design enhances extent of injuries. Strict liability attaches to an automobile design defect which, though not contributing to the collision itself, may have enhanced the injuries sustained. Roberts v. May, 41 Colo. App. 82, 583 P.2d 305 (1978).

For effect on manufacturer's liability where product is unavoidably unsafe, see Belle Bonfils Mem. Blood Bank v. Hansen, 665 P.2d 118 (Colo. 1983).

Warranties arise in every contract for sale unless excluded. Warranties of merchantability and of fitness for a particular purpose assuming all other statutory prerequisites have been met, arise in every contract for sale, unless properly excluded. Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

Defect in design may render product unmerchantable or not fit for the particular purposes for which it was required. Union Supply Co. v. Pust, 196 Colo. 162, 583 P.2d 276 (1978).

Fertilizer containing herbicides was neither fit for its ordinary purpose nor for the farmers particular purpose, and therefor, breaches both the implied warranty of fitness and the implied warranty of merchantability. Deacon v. Am. Plant Food Corp., 782 P.2d 861 (Colo. App. 1989), rev'd on other grounds sub nom. Stone's Farm Supply, Inc. v. Deacon, 805 P.2d 1109 (Colo. 1991).

Admission of industry safety codes as substantive evidence on strict liability issue of whether a product is in a defective condition unreasonably dangerous is valid. Union Supply Co. v. Pust, 196 Colo. 162, 583 P.2d 276 (1978).

Evidence of industry safety standards, when relevant as to a defect must be introduced through an expert, must be authenticated as reliable and bona fide industry-wide safety codes and sufficient advance notice of the intended use of such standards must be given to the adverse party so that he will have sufficient time to prepare to meet the evidence. Union Supply Co. v Pust, 196 Colo. 162, 583 P.2d 276 (1978).

Summary judgment improper where factual question as to reasonableness of design. Where plaintiff's experts raise a factual question about the reasonableness of defendant's design strategies, the drastic remedy of summary judgment is improper, and the issue of whether the design of the car unreasonably increased the risks of injury by collision should be presented to the jury. Roberts v. May, 41 Colo. App. 82, 583 P.2d 305 (1978).

If the buyer has equal or superior skill and experience to that of the seller, has full opportunity to exercise it by examination and actual test in the uses intended, and fails to do so, then he is not warranted in relying solely upon a seller's statement that whatever is about to be furnished will accomplish the desired result. Wallower v. Elder, 126 Colo. 109, 247 P.2d 682 (1952).

Where the transaction is one of oral consummation, any question or dispute arising therefrom as to the matter of whether in implied warranty exists or not is a jury question. Wallower v. Elder, 126 Colo. 109, 247 P.2d 682 (1952).

Where there is no evidence that the seller was informed concerning the particular purpose for which a product is required, and it affirmatively appears that the buyer did not place reliance upon the "skill or judgment" of seller, because they were fully advised that he had no experience with such product, the essential elements set forth in this section which give rise to an implied warranty are wholly absent.

Lindsey v. Stalder, 120 Colo. 58, 208 P.2d 83 (1949).

Where one purchases by relying on the trade name and manufacturer's reputation, there is no implied warranty as to fitness under this section. Elwood Edwards Auto Sales, Inc. v. Kinsey, 123 Colo. 52, 225 P.2d 59 (1950).

Where the sale is of a known, described, and definite article, designed and on the market for a particular purpose, such carries with it a warranty of fitness for the purpose for which it was sold. Platte Valley Motor Co. v. Wagner, 130 Colo. 365, 278 P.2d 870 (1954).

Such fitness for a particular purpose may be merely the equivalent of merchantability; in such a case, the warranties coexist and a recovery may be founded upon either. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

The buyer of a machine may, either under the common law or this section rely upon an implied warranty of fitness for the purpose indicated where he made known to the manufacturer and seller the purpose for which the machine was desired and trusted to the latter's skill and judgment to furnish a machine suitable for the purpose. Duncan v. Bd. of County Comm'rs, 154 Colo. 447, 391 P.2d 368 (1964).

Implied warranty liability extended to component parts manufacturer. As in the area of strict liability, implied warranty liability may extend to the manufacturer of component parts if the lack of fitness for the purpose or use required is found in the component parts before they leave the component parts manufacturer, and not merely in the completed system. Union Supply Co. v. Pust, 196 Colo. 162, 583 P.2d 276 (1978); Shaw v. General Motors Corp., 727 P.2d 387 (Colo. App. 1986).

Warranty applicable to heating system which was moved into buyers' residence for installation and later removed. Thomas v. Bove, 687 P.2d 534 (Colo. App. 1984).

Warranty's existence or breach for trier of fact. The question of the existence of a warranty and whether that warranty was breached is ordinarily one for the trier of fact. Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975); Aetna Cas. & Sur. v. Crissy Fowler Lumber, 687 P.2d 514 (Colo. App. 1984).

Plaintiff established a prima facie case of breach of warranty and injury resulting from that breach, where it was shown that the plaintiff used the product according to the manufacturer's directions for its intended use, and the product was shown to be contaminated and an inference of proximate cause could arise from the fact of proven injury following use of the product. West v. Alberto Culver Co., 486 F.2d 459 (10th Cir. 1973).

Corporation's dissemination of information qualified as warranties. Where a corporation disseminated information using advertising materials, trade publications, or technical publications and oral statements representing the quality of its product, this activity qualifies in law as warranties. Westric Battery Co. v. Standard Elec. Co., 482 F.2d 1307 (10th Cir. 1973).

An implied warranty is present whether the seller is the manufacturer or not; the seller in such instance warrants that the goods are fit for the purpose for which they are purchased. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

Seller is under no duty to inspect or remedy small details of mechanism of national brand articles sold in the ordinary course of business. Am. Furn. Co. v. Veazie, 131 Colo. 340, 281 P.2d 803 (1955).

A seller who has substantially complied with prescribed specifications will not be held to have extended a warranty of fitness for a particular purpose or be held responsible for the consequences of a deficiency in the specifications. Klipfel v. Neill, 30 Colo. App. 428, 494 P.2d 115 (1972); Shaw v. General Motors Corp., 727 P.2d 387 (Colo. App. 1986).

If a manufacturer undertakes to manufacture a machine according to his own judgment and plans, which is intended by the buyer for a disclosed purpose, there is an implied warranty that the machine will be fit for such purpose. Duncan v. Bd. of County Comm'rs, 154 Colo. 447, 391 P.2d 368 (1964).

This section also covers used or secondhand chattels. Wallower v. Elder, 126 Colo. 109, 247 P.2d 682 (1952); Platte Valley Motor Co. v. Wagner, 130 Colo. 365, 278 P.2d 870 (1954).

Where the buyer fails to give seller notice of a claimed breach of such a warranty within reasonable time, this failure relieves seller of any liability. Am. Furn. Co. v. Veazie, 131 Colo. 340, 281 P.2d 803 (1955).

Evidence showed water conditioner unfit for buyer's residence. Cherokee Inv. Co. v. Voiles, 166 Colo. 270, 443 P.2d 727 (1968).

Lessee as third party beneficiary of warranties. Although a lessee of a machine does not directly receive the benefits of the warranties made by the seller to the lessor, the lessee may be a third party beneficiary of such warranties who could "reasonably be expected to use, consume, or be affected by the goods". Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

Applied in Colorado-Ute Elec. Ass'n v. Envirotech Corp., 524 F. Supp. 1152 (D. Colo. 1981).

4-2-316. Exclusion or modification of warranties. (1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit

warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this article on parol or extrinsic evidence (section 4-2-202), negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to subsection (3) of this section, to exclude or modify the implied warranty of merchantability or any part of it, the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(3) Notwithstanding subsection (2) of this section:

(a) Unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", "with all faults", or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) When the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods, there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) An implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this article on liquidation or limitation of damages and on contractual modification of remedy (sections 4-2-718 and 4-2-719).

Source: L. 65: p. 1311, § 1. **C.R.S. 1963:** § 155-2-316.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None. See sections 15 and 71, Uniform Sales Act.

Purposes:

1. This section is designed principally to deal with those frequent clauses in sales contracts which seek to exclude "all warranties, express or implied." It seeks to protect a buyer from unexpected and unbargained language of disclaimer by denying effect to such language when inconsistent with language of express warranty and permitting the exclusion of implied warranties only by conspicuous language or other circumstances which protect the buyer from surprise.

2. The seller is protected under this Article against false allegations of oral warranties by its provisions on parol and extrinsic evidence and against unauthorized representations by the customary "lack of authority" clauses. This Article treats the limitation or avoidance of consequential damages as a matter of limiting remedies for breach, separate from the matter of creation of liability under a warranty. If no warranty exists, there is of course no problem of limiting remedies for breach of warranty. Under subsection (4) the question of limitation of remedy is governed by the sections referred to rather than by this section.

3. Disclaimer of the implied warranty of merchantability is permitted under subsection (2), but with the safeguard that such disclaimers must mention merchantability and in case of a writing must be conspicuous.

4. Unlike the implied warranty of merchantability, implied warranties of fitness for a particular purpose may be excluded by general language, but only if it is in writing and conspicuous.

5. Subsection (2) presupposes that the implied warranty in question exists unless excluded or modified. Whether or not language of disclaimer satisfies the requirements of this section, such language may be relevant under other sections to the question whether the warranty was ever in fact created. Thus, unless the provisions of this Article on parol and extrinsic evidence prevent, oral language of disclaimer may raise issues of fact as to whether reliance by the buyer occurred and whether the seller had "reason to know" under the section on implied warranty of fitness for a particular purpose.

6. The exceptions to the general rule set forth in paragraphs (a), (b) and (c) of subsection (3) are common factual situations in which the circumstances surrounding the transaction are in themselves sufficient to call the buyer's attention to the fact that no implied warranties are made or that a certain implied warranty is being excluded.

7. Paragraph (a) of subsection (3) deals with general terms such as "as is," "as they stand," "with all faults," and the like. Such terms in ordinary commercial usage are understood to mean that the buyer takes the entire risk as to the quality of the goods involved. The terms cov-

ered by paragraph (a) are in fact merely a particularization of paragraph (c) which provides for exclusion or modification of implied warranties by usage of trade.

8. Under paragraph (b) of subsection (3) warranties may be excluded or modified by the circumstances where the buyer examines the goods or a sample or model of them before entering into the contract. "Examination" as used in this paragraph is not synonymous with inspection before acceptance or at any other time after the contract has been made. It goes rather to the nature of the responsibility assumed by the seller at the time of the making of the contract. Of course if the buyer discovers the defect and uses the goods anyway, or if he unreasonably fails to examine the goods before he uses them, resulting injuries may be found to result from his own action rather than proximately from a breach of warranty. See Sections 2-314 and 2-715 and comments thereto.

In order to bring the transaction within the scope of "refused to examine" in paragraph (b), it is not sufficient that the goods are available for inspection. There must in addition be a demand by the seller that the buyer examine the goods fully. The seller by the demand puts the buyer on notice that he is assuming the risk of defects which the examination ought to reveal. The language "refused to examine" in this paragraph is intended to make clear the necessity for such demand.

Application of the doctrine of "caveat emptor" in all cases where the buyer examines the goods regardless of statements made by the seller is, however, rejected by this Article. Thus, if the offer of examination is accompanied by words as to their merchantability or specific attributes and the buyer indicates clearly that he is relying on those words rather than on his examination, they give rise to an "express" warranty. In such cases the question is one of fact as to whether a warranty of merchantability has been expressly incorporated in the agreement. Disclaimer of such an express warranty is governed by subsection (1) of the present section.

The particular buyer's skill and the normal method of examining goods in the circumstances determine what defects are excluded by the examination. A failure to notice defects which are obvious cannot excuse the buyer. However, an examination under circumstances which do not permit chemical or other testing of the goods would not exclude defects which could be ascertained only by such testing. Nor can latent defects be excluded by a simple examination. A professional buyer examining a product in his field will be held to have assumed the risk as to all defects which a professional in the field ought to observe, while a nonprofessional buyer will be held to have assumed the risk only for such defects as a layman might be expected to observe.

9. The situation in which the buyer gives precise and complete specifications to the seller is not explicitly covered in this section, but this is a frequent circumstance by which the implied warranties may be excluded. The warranty of fitness for a particular purpose would not normally arise since in such a situation there is usually no reliance on the seller by the buyer. The warranty of merchantability in such a transaction, however, must be considered in connection with the next section on the cumulation and conflict of warranties. Under paragraph (c) of that section in case of such an inconsistency the implied warranty of merchantability is displaced by the express warranty that the goods will comply with the specifications. Thus, where the buyer gives detailed specifications as to the goods, neither of the implied warranties as to quality will normally apply to the transaction unless consistent with the specifications.

Cross References:

Point 2: Sections 4-2-202, 4-2-718 and 4-2-719.

Point 7: Sections 4-1-205 and 4-2-208.

Definitional Cross References:

"Agreement". Section 4-1-201.
"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Course of dealing". Section 4-1-205.
"Goods". Section 4-2-105.
"Remedy". Section 4-1-201.
"Seller". Section 4-2-103.
"Usage of trade". Section 4-1-205.

ANNOTATION

Law reviews. For article, "Exclusion and Modification of Warranty under the U.C.C. — How to Succeed in Business Without Being Liable for Not Really Trying", see 46 Den. L.J. 579 (1969). For article, "The 'Battle of the Forms' Under the Colorado Uniform Commercial Code", see 11 Colo. Law. 78 (1982).

Annotator's note. Since § 4-2-316 is similar to repealed § 121-1-71, C.R.S. 1963 (uniform sales act), relevant cases construing § 121-1-71 have been included in the annotations to this section.

A broad general disclaimer clause may negate implied warranties if there is a negotiated contract between a commercial seller and a commercial buyer, Cherokee Inv. Co. v. Voiles, 166 Colo. 270, 443 P.2d 727 (1968).

But it is not appropriate to a consumer who purchases after a home demonstration. Cherokee Inv. Co. v. Voiles, 166 Colo. 270, 443 P.2d

727 (1968).

Negating implied warranty of fitness for particular purpose by general disclaimer. The uniform commercial code, in providing for an implied warranty of fitness for a particular purpose, announced a public policy adopted by the general assembly to give buyers protection against sellers of unfit merchandise under certain conditions. In order to negative this declaration of public policy, the express agreement provided for in this section must be clear, unequivocal, and the result of a genuine agreement between the parties, and where there is an attempt to negative an implied warranty of fitness by a broad general disclaimer, it must appear that the so-called disclaimer was clearly brought to the attention of the buyer and agreed to by him in order for this disclaimer to be effective. Cherokee Inv. Co. v. Voiles, 166 Colo. 270, 443 P.2d 727 (1968); Miehle Co. v. Smith-Brooks Printing Co., 303 F. Supp. 501 (D. Colo. 1969).

Warranties arise in every contract for sale unless excluded. Warranties of merchantability and of fitness for a particular purpose assuming all other statutory prerequisites have been met, arise in every contract for sale, unless properly excluded. Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

How implied warranty of fitness excluded. An implied warranty of fitness for a particular purpose can be excluded by a conspicuous writing which states generally that there are no warranties extending beyond the description in the contract. O'Neil v. Int'l. Harvester Co., 40 Colo. App. 369, 575 P.2d 862 (1978).

Where a buyer alleges the existence of oral warranties prior to execution of a written contract and there is conduct following the sale which tends to show that warranties were in fact made, there is a material issue of fact for resolution, namely, whether the parties intended the written contract to be a final expression of their agreement, and, if not, what the terms actually agreed upon by the parties consisted of. Evidence of both oral warranties and the conduct of the parties subsequent to signing the contract is admissible for purpose of resolving this issue. O'Neil v. Int'l. Harvester Co., 40 Colo. App. 369, 575 P.2d 862 (1978).

Provision in contract stating that it was sole warranty does not negate buyer's claim of negligent misrepresentation and parol evidence as to such misrepresentation allowable. Keller v. A.O. Harvestore Prods., 819 P.2d 69 (Colo. 1991).

Disclaimer of implied warranty of merchantability is required to include the word "merchantability" and prevalent view is that the provisions of subsection (3) do not qualify this requirement. Richard O'Brien Companies v. Challenge-Cook Bros., 672 F. Supp. 466 (D. Colo. 1987).

Where an inspection of inventory under this section would not have revealed defect affecting merchantability, claim of breach of implied warranty of merchantability under § 4-2-314 is not excluded by reason of such inspection. Loden v. Drake, 881 P.2d 467 (Colo. App. 1994).

Applied in Hummel v. Skyline Dodge, Inc., 41 Colo. App. 572, 589 P.2d 73 (1978); Colorado-Ute Elec. Ass'n v. Envirotech Corp., 524 F. Supp. 1152 (D. Colo. 1981); Universal Drilling Co. v. Camay Drilling Co., 737 F.2d 869 (10th Cir. 1984).

4-2-317. Cumulation and conflict of warranties express or implied. Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable, the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:

(a) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) A sample from an existing bulk displaces inconsistent general language of description.

(c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

Source: L. 65: p. 1312, § 1. **C.R.S. 1963:** § 155-2-317.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: On cumulation of warranties see Sections 14, 15, and 16, Uniform Sales Act.

Changes: Completely rewritten into one section.

Purposes of Changes:

1. The present section rests on the basic policy of this Article that no warranty is created except by some conduct (either affirmative action or failure to disclose) on the part of the

seller. Therefore, all warranties are made cumulative unless this construction of the contract is impossible or unreasonable.

This Article thus follows the general policy of the Uniform Sales Act except that in case of the sale of an article by its patent or trade name the elimination of the warranty of fitness depends solely on whether the buyer has relied on the seller's skill and judgment; the use of the patent or trade name is but one factor in making this determination.

2. The rules of this section are designed to aid in determining the intention of the parties as to which of inconsistent warranties which have arisen from the circumstances of their transaction shall prevail. These rules of intention are to be applied only where factors making for an equitable estoppel of the seller do not exist and where he has in perfect good faith made warranties which later turn out to be inconsistent. To the extent that the seller has led the buyer to believe that all of the warranties can be performed, he is estopped from setting up any essential inconsistency as a defense.

3. The rules in subsections (a), (b) and (c) are designed to ascertain the intention of the parties by reference to the factor which probably claimed the attention of the parties in the first instance. These rules are not absolute but may be changed by evidence showing that the conditions which existed at the time of contracting make the construction called for by the section inconsistent or unreasonable.

Cross Reference:

Point 1: Section 4-2-315.

Definitional Cross Reference:

"Party". Section 4-1-201.

4-2-318. Third party beneficiaries of warranties express or implied. A seller's warranty whether express or implied extends to any person who may reasonably be expected to use, consume, or be affected by the goods and who is injured by breach of the warranty. A seller may not exclude or limit the operation of this section.

Source: L. 65: p. 1312, § 1. **C.R.S. 1963:** § 155-2-318.

Editor's note - Colorado legislative change: Colorado changed "natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may" to read "person who may reasonably be expected to".

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. The last sentence of this section does not mean that a seller is precluded from excluding or disclaiming a warranty which might otherwise arise in connection with the sale provided such exclusion or modification is permitted by Section 2-316. Nor does that sentence preclude the seller from limiting the remedies of his own buyer and of any beneficiaries, in any manner provided in Sections 2-718 or 2-719. To the extent that the contract of sale contains provisions under which warranties are excluded or modified, or remedies for breach are limited, such provisions are equally operative against beneficiaries of warranties under this section. What this last sentence forbids is exclusion of liability by the seller to the persons to whom the warranties which he has made to his buyer would extend under this section.

2. The purpose of this section is to give certain beneficiaries the benefit of the same warranty which the buyer received in the contract of sale, thereby freeing any such beneficiaries from any technical rules as to "privity." It seeks to accomplish this purpose without any derogation of any right or remedy resting on negligence. It rests primarily upon the merchant-seller's warranty under this Article that the goods sold are merchantable and fit for the ordinary purposes for which such goods are used rather than the warranty of fitness for a particular purpose. Implicit in the section is that any beneficiary of a warranty may bring a direct action for breach of warranty against the seller whose warranty extends to him [As amended in 1966].

3. The first alternative expressly includes as beneficiaries within its provisions the family, household and guests of the purchaser. Beyond this, the section in this form is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain.

The second alternative is designed for states where the case law has already developed further and for those that desire to expand the class of beneficiaries. The third alternative goes further, following the trend of modern decisions as indicated by Restatement of Torts 2d § 402A (Tentative Draft No. 10, 1965) in extending the rule beyond injuries to the person [As amended in 1966].

Cross References:

Point 1: Sections 4-2-316, 4-2-718 and 4-2-719.

Point 2: Section 4-2-314.

Definitional Cross References:

"Buyer". Section 4-2-103.

"Goods". Section 4-2-105.

"Seller". Section 4-2-103.

COLORADO COMMENT

This section, as amended by Colorado, extends to any person reasonably expected to use, consume, or be affected by goods the same warranty which the buyer received in the contract of sale, thereby freeing any such beneficiaries from any technical rules as to "privity". The Colorado change enlarges the potential liability of a seller by extending the warranty to other persons in the distributive chain. This section seeks to accomplish this purpose without any derogation of any right or remedy resting on negligence. It rests primarily upon the merchant-seller's warranty under this Article that the goods sold are merchantable and fit for the ordinary purposes for which such goods are used rather than the warranty of fitness for a particular purpose. Implicit in the section is that any beneficiary of a warranty may bring a direct action for breach of warranty against the seller whose warranty extends to him.

ANNOTATION

The general assembly has expanded the class of persons protected by express and implied warranties beyond that set forth in the original uniform code. Prutch v. Ford Motor Co., 40 Colo. App. 129, 574 P.2d 102 (1977), rev'd on other grounds, 618 P.2d 657 (Colo. 1980).

Privity is not required in warranty actions. Pust v. Union Supply Co., 38 Colo. App. 435, 561 P.2d 355 (1976), rev'd sub nom. Holly Sugar Corp. v. Union Supply Co., 194 Colo. 316, 572 P.2d 148 (1977)(party indemnification issue), and aff'd, 196 Colo. 162, 583 P.2d 276 (1978).

Properly executed limitations of warranties or available remedies are equally applicable to anyone that would be a beneficiary of a seller's warranty. Wenner Petro. v. Mitsui & Co., 748 P.2d 356 (Colo. App. 1987).

There is no indication that the general assembly intended to include arbitration as a limitation which could be imposed on remote purchasers through the operation of this section. Recold, S.A. De C.V. v. Monfort of Colo., Inc., 893 F.2d 195 (8th Cir. 1990).

Lessee as beneficiary. Although a lessee of a machine does not directly receive the benefits of the warranties made by the seller to the lessor, the lessee may be a third party beneficiary of such warranties who could "reasonably be expected to use, consume, or be affected by the goods". Lease Fin., Inc. v. Burger, 40 Colo. App. 107, 575 P.2d 857 (1977).

Warranties provided by the uniform commercial code are not the exclusive means of recovery without a showing of negligence or fault. Larson v. Clark Equip. Co., 33 Colo. App. 277, 518 P.2d 308 (1974).

Judicial adoption of strict liability in tort not precluded. The legislative adoption of the UCC warranties without a privity requirement did not preclude the judicial adoption of strict liability in tort. Larson v. Clark Equip. Co., 33 Colo. App. 277, 518 P.2d 308 (1974).

For discussion of the distinction between liability in contract for breach of warranty and strict tort liability for product misrepresentation, see Am. Safety Equip. Corp. v. Winkler, 640 P.2d 216 (Colo. 1982).

Applied in Hansen v. Mercy Hosp., 40 Colo. App. 17, 570 P.2d 1309 (1977).

4-2-319. F.O.B. and F.A.S. terms. (1) Unless otherwise agreed the term F.O.B. (which means "free on board") at a named place, even though used only in connection with the stated price, is a delivery term under which:

(a) When the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this article (section 4-2-504) and bear the expense and risk of putting them into the possession of the carrier; or

(b) When the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this article (section 4-2-503);

(c) When under either paragraph (a) or (b) of this subsection the term is also F.O.B. vessel, car, or other vehicle, the seller must in addition at his own expense and risk load the goods on board. If the term is F.O.B. vessel the buyer must name the vessel and in an appropriate case the seller must comply with the provisions of this article on the form of bill of lading (section 4-2-323).

(2) Unless otherwise agreed, the term F.A.S. vessel (which means "free alongside") at a named port, even though used only in connection with the stated price, is a delivery term under which the seller must:

(a) At his own expense and risk deliver the goods alongside the vessel in the manner usual in that port or on a dock designated and provided by the buyer; and

(b) Obtain and tender a receipt for the goods in exchange for which the carrier is under a duty to issue a bill of lading.

(3) Unless otherwise agreed in any case falling within subsection (1) (a) or (1) (c) or subsection (2) of this section, the buyer must seasonably give any needed instructions for making delivery, including when the term is F.A.S. or F.O.B. the loading berth of the vessel and in an appropriate case its name and sailing date. The seller may treat the failure of needed instructions as a failure of cooperation under this article (section 4-2-311). He may also at his option move the goods in any reasonable manner preparatory to delivery or shipment.

(4) Under the term "F.O.B. vessel" or "F.A.S.", unless otherwise agreed, the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

Source: L. 65: p. 1313, § 1. **C.R.S. 1963:** § 155-2-319.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section is intended to negate the uncommercial line of decision which treats an "F.O.B." term as "merely a price term." The distinctions taken in subsection (1) handle most of the issues which have on occasion led to the unfortunate judicial language just referred to. Other matters which have led to sound results being based on unhappy language in regard to F.O.B. clauses are dealt with in this Act by Section 2-311(2) (seller's option re arrangements relating to shipment) and Sections 2-614 and 615 (substituted performance and seller's excuse).

2. Subsection (1)(c) not only specifies the duties of a seller who engages to deliver "F.O.B. vessel," or the like, but ought to make clear that no agreement is soundly drawn when it looks to reshipment from San Francisco or New York, but speaks merely of "F.O.B." the place.

3. The buyer's obligations stated in subsection (1)(c) and subsection (3) are, as shown in the text, obligations of cooperation. The last sentence of subsection (3) expressly, though perhaps unnecessarily, authorizes the seller, pending instructions, to go ahead with such preparatory moves as shipment from the interior to the named point of delivery. The sentence presupposes the usual case in which instructions "fail"; a prior repudiation by the buyer, giving notice that breach was intended, would remove the reason for the sentence, and would normally bring into play, instead, the second sentence of Section 2-704, which duly calls for lessening damages.

4. The treatment of "F.O.B. vessel" in conjunction with F.A.S. fits, in regard to the need for payment against documents, with standard practice and case-law; but "F.O.B. vessel" is a term which by its very language makes express the need for an "on board" document. In this respect, that term is stricter than the ordinary overseas "shipment" contract (C.I.F., etc., Section 2-320).

Cross References:

Sections 4-2-311(3), 4-2-323, 4-2-503 and 4-2-504.

Definitional Cross References:

"Agreed". Section 4-1-201.
"Bill of lading". Section 4-1-201.
"Buyer". Section 4-2-103.
"Goods". Section 4-2-105.
"Seasonably". Section 4-1-204.
"Seller". Section 4-2-103.
"Term". Section 4-1-201.

4-2-320. C.I.F. and C. & F. terms. (1) The term "C.I.F." means that the price includes in a lump sum the cost of the goods and the insurance and freight to the named destination. The term "C. & F." or "C.F." means that the price so includes cost and freight to the named destination.

(2) Unless otherwise agreed and even though used only in connection with the stated price and destination, the term "C.I.F. destination" or its equivalent requires the seller at his own expense and risk to:

(a) Put the goods into the possession of a carrier at the port for shipment and obtain a

negotiable bill or bills of lading covering the entire transportation to the named destination; and

(b) Load the goods and obtain a receipt from the carrier (which may be contained in the bill of lading) showing that the freight has been paid or provided for; and

(c) Obtain a policy or certificate of insurance, including any war risk insurance, of a kind and on terms then current at the port of shipment in the usual amount, in the currency of the contract, shown to cover the same goods covered by the bill of lading and providing for payment of loss to the order of the buyer or for the account of whom it may concern; but the seller may add to the price the amount of the premium for any such war risk insurance; and

(d) Prepare an invoice of the goods and procure any other documents required to effect shipment or to comply with the contract; and

(e) Forward and tender with commercial promptness all the documents in due form and with any indorsement necessary to perfect the buyer's rights.

(3) Unless otherwise agreed the term "C. & F." or its equivalent has the same effect and imposes upon the seller the same obligations and risks as a "C.I.F." term except the obligation as to insurance.

(4) Under the term "C.I.F." or "C. & F.", unless otherwise agreed, the buyer must make payment against tender of the required documents and the seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

Source: L. 65: p. 1314, § 1. **C.R.S. 1963:** § 155-2-320.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To make it clear that:

1. The C.I.F. contract is not a destination but a shipment contract with risk of subsequent loss or damage to the goods passing to the buyer upon shipment if the seller has properly performed all his obligations with respect to the goods. Delivery to the carrier is delivery to the buyer for purposes of risk and "title". Delivery of possession of the goods is accomplished by delivery of the bill of lading, and upon tender of the required documents the buyer must pay the agreed price without awaiting the arrival of the goods and if they have been lost or damaged after proper shipment he must seek his remedy against the carrier or insurer. The buyer has no right of inspection prior to payment or acceptance of the documents.

2. The seller's obligations remain the same even though the C.I.F. term is "used only in connection with the stated price and destination".

3. The insurance stipulated by the C.I.F. term is for the buyer's benefit, to protect him against the risk of loss or damage to the goods in transit. A clause in a C.I.F. contract "insurance-for the account of sellers" should be viewed in its ordinary mercantile meaning that the sellers must pay for the insurance and not that it is intended to run to the seller's benefit.

4. A bill of lading covering the entire transportation from the port of shipment is explicitly required but the provision on this point must be read in the light of its reason to assure the buyer of as full protection as the conditions of shipment reasonably permit, remembering always that this type of contract is designed to move the goods in the channels commercially available. To enable the buyer to deal with the goods while they are afloat the bill of lading must be one that covers only the quantity of goods called for by the contract. The buyer is not required to accept his part of the goods without a bill of lading because the latter covers a larger quantity, nor is he required to accept a bill of lading for the whole quantity under a stipulation to hold the excess for the owner. Although the buyer is not compelled to accept either goods or documents under such circumstances he may of course claim his rights in any goods which have been identified to his contract.

5. The seller is given the option of paying or providing for the payment of freight. He has no option to ship "freight collect" unless the agreement so provides. The rule of the common law that the buyer need not pay the freight if the goods do not arrive is preserved.

Unless the shipment has been sent "freight collect" the buyer is entitled to receive documentary evidence that he is not obligated to pay the freight; the seller is therefore required to obtain a receipt "showing that the freight has been paid or provided for." The usual notation in the appropriate space on the bill of lading that the freight has been prepaid is a sufficient receipt, as at common law. The phrase "provided for" is intended to cover the frequent situation in which the carrier extends credit to a shipper for the freight on successive shipments and receives periodical payments of the accrued freight charges from him.

6. The requirement that unless otherwise agreed the seller must procure insurance "of a kind and on terms then current at the port for shipment in the usual amount, in the currency of the contract, sufficiently shown to cover the same goods covered by the bill of lading", applies to both marine and war risk insurance. As applied to marine insurance, it means such insurance as is usual or customary at the port for shipment with reference to the particular kind of goods involved, the character and equipment of the vessel, the route of the voyage, the port of destination and any other considerations that affect the risk. It is the substantial equivalent of the ordinary insurance in the particular trade and on the particular voyage and is subject to agreed specifications of type or extent of coverage. The language does not mean that the insurance must be adequate to cover all risks to which the goods may be subject in transit. There are some types of loss or damage that are not covered by the usual marine insurance and are excepted in bills of lading or in applicable statutes from the causes of loss or damage for which the carrier or the vessel is liable. Such risks must be borne by the buyer under this Article.

Insurance secured in compliance with a C.I.F. term must cover the entire transportation of the goods to the named destination.

7. An additional obligation is imposed upon the seller in requiring him to procure customary war risk insurance at the buyer's expense. This changes the common law on the point. The seller is not required to assume the risk of including in the C.I.F. price the cost of such insurance, since it often fluctuates rapidly, but is required to treat it simply as a necessary for the buyer's account. What war risk insurance is "current" or usual turns on the standard forms of policy or rider in common use.

8. The C.I.F. contract calls for insurance covering the value of the goods at the time and place of shipment and does not include any increase in market value during transit or any anticipated profit to the buyer on a sale by him.

The contract contemplates that before the goods arrive at their destination they may be sold again and again on C.I.F. terms and that the original policy of insurance and bill of lading will run with the interest in the goods by being transferred to each successive buyer. A buyer who becomes the seller in such an intermediate contract for sale does not thereby, if his sub-buyer knows the circumstances, undertake to insure the goods again at an increased price fixed in the new contract or to cover the increase in price by additional insurance, and his buyer may not reject the documents on the ground that the original policy does not cover such higher price. If such a sub-buyer desires additional insurance he must procure it for himself.

Where the seller exercises an option to ship "freight collect" and to credit the buyer with the freight against the C.I.F. price, the insurance need not cover the freight since the freight is not at the buyer's risk. On the other hand, where the seller prepays the freight upon shipping under a bill of lading requiring prepayment and providing that the freight shall be deemed earned and shall be retained by the carrier "ship and/or cargo lost or not lost," or using words of similar import, he must procure insurance that will cover the freight, because notwithstanding that the goods are lost in transit the buyer is bound to pay the freight as part of the C.I.F. price and will be unable to recover it back from the carrier.

9. Insurance "for the account of whom it may concern" is usual and sufficient. However, for a valid tender the policy of insurance must be one which can be disposed of together with the bill of lading and so must be "sufficiently shown to cover the same goods covered by the bill of lading". It must cover separately the quantity of goods called for by the buyer's contract and not merely insure his goods as part of a larger quantity in which others are interested, a case provided for in American mercantile practice by the use of negotiable certificates of insurance which are expressly authorized by this section. By usage these certificates are treated as the equivalent of separate policies and are good tender under C.I.F. contracts. The term "certificate of insurance", however, does not of itself include certificates or "cover notes" issued by the insurance broker and stating that the goods are covered by a policy. Their sufficiency as substitutes for policies will depend upon proof of an established usage or course of dealing. The present section rejects the English rule that not only brokers' certificates and "cover notes" but also certain forms of American insurance certificates are not the equivalent of policies and are not good tender under a C.I.F. contract.

The seller's failure to tender a proper insurance document is waived if the buyer refuses to make payment on other and untenable grounds at a time when proper insurance could have been obtained and tendered by the seller if timely objection had been made. Even a failure to insure on shipment may be cured by seasonable tender of a policy retroactive in effect; e.g., one insuring the goods "lost or not lost." The provisions of this Article on cure of improper tender and on waiver of buyer's objections by silence are applicable to insurance tenders under a C.I.F. term. Where there is no waiver by the buyer as described above, however, the fact that the goods arrive safely does not cure the seller's breach of his obligations to insure them and tender to the buyer a proper insurance document.

10. The seller's invoice of the goods shipped under a C.I.F. contract is regarded as a usual and necessary document upon which reliance may properly be placed. It is the document

which evidences points of description, quality and the like which do not readily appear in other documents. This Article rejects those statements to the effect that the invoice is a usual but not a necessary document under a C.I.F. term.

11. The buyer needs all of the documents required under a C.I.F. contract, in due form and with necessary endorsements, so that before the goods arrive he may deal with them by negotiating the documents or may obtain prompt possession of the goods after their arrival. If the goods are lost or damaged in transit the documents are necessary to enable him promptly to assert his remedy against the carrier or insurer. The seller is therefore obligated to do what is mercantilely reasonable in the circumstances and should make every reasonable exertion to send forward the documents as soon as possible after the shipment. The requirement that the documents be forwarded with "commercial promptness" expresses a more urgent need for action than that suggested by the phrase "reasonable time".

12. Under a C.I.F. contract the buyer, as under the common law, must pay the price upon tender of the required documents without first inspecting the goods, but his payment in these circumstances does not constitute an acceptance of the goods nor does it impair his right of subsequent inspection or his options and remedies in the case of improper delivery. All remedies and rights for the seller's breach are reserved to him. The buyer must pay before inspection and assert his remedy against the seller afterward unless the nonconformity of the goods amounts to a real failure of consideration, since the purpose of choosing this form of contract is to give the seller protection against the buyer's unjustifiable rejection of the goods at a distant port of destination which would necessitate taking possession of the goods and suing the buyer there.

13. A valid C.I.F. contract may be made which requires part of the transportation to be made on land and part on the sea, as where the goods are to be brought by rail from an inland point to a seaport and thence transported by vessel to the named destination under a "through" or combination bill of lading issued by the railroad company. In such a case shipment by rail from the inland point within the contract period is a timely shipment notwithstanding that the loading of the goods on the vessel is delayed by causes beyond the seller's control.

14. Although subsection (2) stating the legal effects of the C.I.F. term is an "unless otherwise agreed" provision, the express language used in an agreement is frequently a precautionary, fuller statement of the normal C.I.F. terms and hence not intended as a departure or variation from them. Moreover, the dominant outlines of the C.I.F. term are so well understood commercially that any variation should, whenever reasonably possible, be read as falling within those dominant outlines rather than as destroying the whole meaning of a term which essentially indicates a contract for proper shipment rather than one for delivery at destination. Particularly careful consideration is necessary before a printed form or clause is construed to mean agreement otherwise and where a C.I.F. contract is prepared on a printed form designed for some other type of contract, the C.I.F. terms must prevail over printed clauses repugnant to them.

15. Under subsection (4) the fact that the seller knows at the time of the tender of the documents that the goods have been lost in transit does not affect his rights if he has performed his contractual obligations. Similarly, the seller cannot perform under a C.I.F. term by purchasing and tendering landed goods.

16. Under the C. & F. term, as under the C.I.F. term, title and risk of loss are intended to pass to the buyer on shipment. A stipulation in a C. & F. contract that the seller shall effect insurance on the goods and charge the buyer with the premium (in effect that he shall act as the buyer's agent for that purpose) is entirely in keeping with the pattern. On the other hand, it often happens that the buyer is in a more advantageous position than the seller to effect insurance on the goods or that he has in force an "open" or "floating" policy covering all shipments made by him or to him, in either of which events the C. & F. term is adequate without mention of insurance.

17. It is to be remembered that in a French contract the term "C.A.F." does not mean "Cost and Freight" but has exactly the same meaning as the term "C.I.F." since it is merely the French equivalent of that term. The "A" does not stand for "and" but for "assurance" which means insurance.

Cross References:

Point 4: Section 4-2-323.
Point 6: Section 4-2-509(1)(a).
Point 9: Sections 4-2-508 and 4-2-605(1)(a).
Point 12: Sections 4-2-321(3), 4-2-512 and 4-2-513(3) and Article 5.

Definitional Cross References:

"Bill of lading". Section 4-1-201.
"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Goods". Section 4-2-105.
"Rights". Section 4-1-201.
"Seller". Section 4-2-103.
"Term". Section 4-1-201.

4-2-321. C.I.F. or C. & F. - "net landed weights" - "payment on arrival" - warranty of condition on arrival. Under a contract containing a term "C.I.F." or "C. & F.":

(1) Where the price is based on or is to be adjusted according to "net landed weights", "delivered weights", "out turn" quantity or quality, or the like, unless otherwise agreed the seller must reasonably estimate the price. The payment due on tender of the documents called for by the contract is the amount so estimated, but after final adjustment of the price a settlement must be made with commercial promptness.

(2) An agreement described in subsection (1) of this section or any warranty of quality or condition of the goods on arrival places upon the seller the risk of ordinary deterioration, shrinkage, and the like in transportation, but has no effect on the place or time of identification to the contract for sale or delivery or on the passing of the risk of loss.

(3) Unless otherwise agreed, where the contract provides for payment on or after arrival of the goods, the seller must before payment allow such preliminary inspection as is feasible; but if the goods are lost, delivery of the documents and payment are due when the goods should have arrived.

Source: L. 65: p. 1314, § 1. **C.R.S. 1963:** § 155-2-321.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

This section deals with two variations of the C.I.F. contract which have evolved in mercantile practice but are entirely consistent with the basic C.I.F. pattern. Subsections (1) and (2), which provide for a shift to the seller of the risk of quality and weight deterioration during shipment, are designed to conform the law to the best mercantile practice and usage without changing the legal consequences of the C.I.F. or C. & F. term as to the passing of marine risks to the buyer at the point of shipment. Subsection (3) provides that where under the contract documents are to be presented for payment after arrival of the goods, this amounts merely to a postponement of the payment under the C.I.F. contract and is not to be confused with the "no arrival, no sale" contract. If the goods are lost, delivery of the documents and payment against them are due when the goods should have arrived. The clause for payment on or after arrival is not to be construed as such a condition precedent to payment that if the goods are lost in transit the buyer need never pay and the seller must bear the loss.

Cross Reference:

Section 4-2-324.

Definitional Cross References:

"Agreement". Section 4-1-201.
"Contract". Section 4-1-201.
"Delivery". Section 4-1-201.
"Goods". Section 4-2-105.
"Seller". Section 4-2-103.
"Term". Section 4-1-201.

4-2-322. Delivery "ex-ship". (1) Unless otherwise agreed, a term for delivery of goods "ex-ship" (which means from the carrying vessel) or in equivalent language is not restricted to a particular ship and requires delivery from a ship which has reached a place at the named port of destination where goods of the kind are usually discharged.

(2) Under such a term unless otherwise agreed:

(a) The seller must discharge all liens arising out of the carriage and furnish the buyer with a direction which puts the carrier under a duty to deliver the goods; and

(b) The risk of loss does not pass to the buyer until the goods leave the ship's tackle or are otherwise properly unloaded.

Source: L. 65: p. 1315, § 1. **C.R.S. 1963:** § 155-2-322.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. The delivery term, "ex-ship", as between seller and buyer, is the reverse of the f.a.s. term covered.

2. Delivery need not be made from any particular vessel under a clause calling for delivery "ex-ship", even though a vessel on which shipment is to be made originally is named in the contract, unless the agreement by appropri-

ate language, restricts the clause to delivery from a named vessel.

3. The appropriate place and manner of unloading at the port of destination depend upon the nature of the goods and the facilities and usages of the port.

4. A contract fixing a price "ex-ship" with payment "cash against documents" calls only for such documents as are appropriate to the contract. Tender of a delivery order and of a receipt for the freight after the arrival of the carrying vessel is adequate. The seller is not required to tender a bill of lading as a document of title nor is he required to insure the goods for the buyer's benefit, as the goods are not at the buyer's risk during the voyage.

Cross Reference:

Point 1: Section 4-2-319(2).

Definitional Cross References:

"Buyer". Section 4-2-103.
"Goods". Section 4-2-105.
"Seller". Section 4-2-103.
"Term". Section 4-1-201.

4-2-323. Form of bill of lading required in overseas shipment - "overseas". (1) Where the contract contemplates overseas shipment and contains a term "C.I.F." or "C. & F." or "F.O.B. vessel", the seller, unless otherwise agreed, must obtain a negotiable bill of lading stating that the goods have been loaded on board or, in the case of a term "C.I.F." or "C. & F.", received for shipment.

(2) Where in a case within subsection (1) of this section a tangible bill of lading has been issued in a set of parts, unless otherwise agreed, if the documents are not to be sent from abroad the buyer may demand tender of the full set; otherwise, only one part of the bill of lading need be tendered. Even if the agreement expressly requires a full set:

(a) Due tender of a single part is acceptable within the provisions of this article on cure of improper delivery (subsection (1) of section 4-2-508); and

(b) Even though the full set is demanded, if the documents are sent from abroad the person tendering an incomplete set may nevertheless require payment upon furnishing an indemnity which the buyer in good faith deems adequate.

(3) A shipment by water or by air, or a contract contemplating such shipment, is "overseas" insofar as by usage of trade or agreement it is subject to the commercial, financing, or shipping practices characteristic of international deep water commerce.

Source: L. 65: p. 1315, § 1. **C.R.S. 1963:** § 155-2-323. **L. 2006:** IP(2) amended, p. 491, § 8, effective September 1.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Subsection (1) follows the "American" rule that a regular bill of lading indicating delivery of the goods at the dock for shipment is sufficient, except under a term "F.O.B. vessel." See Section 2-319 and comment thereto.

2. Subsection (2) deals with the problem of bills of lading covering deep water shipments, issued not as a single bill of lading but in a set of parts, each part referring to the other parts and the entire set constituting in commercial practice and at law a single bill of lading. Commercial practice in international commerce is to accept and pay against presentation of the first part of a set if the part is sent from overseas even though the contract of the buyer requires presentation of a full set of bills of lading provided adequate indemnity for the missing parts is forthcoming.

This subsection codifies that practice as between buyer and seller. Article 5 (Section 5-113) authorizes banks presenting drafts under letters of credit to give indemnities against the missing parts, and this subsection means that the buyer must accept and act on such indemnities if he in good faith deems them adequate. But neither this subsection nor Article 5 decides whether a bank which has issued a letter of credit is similarly bound. The issuing bank's obligation under a letter of credit is independent and depends on its own terms. See Article 5.

Cross References:

Sections 4-2-508(2), 5-113.

Definitional Cross References:

"Bill of lading". Section 4-1-201.
"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Delivery". Section 4-1-201.
"Financing agency". Section 4-2-104.
"Person". Section 4-1-201.
"Seller". Section 4-2-103.
"Send". Section 4-1-201.
"Term". Section 4-1-201.

4-2-324. "No arrival, no sale" term. Under a term "no arrival, no sale" or terms of like meaning, unless otherwise agreed:

(a) The seller must properly ship conforming goods and if they arrive by any means he must tender them on arrival, but he assumes no obligation that the goods will arrive unless he has caused the nonarrival; and

(b) Where without fault of the seller the goods are in part lost or have so deteriorated as no longer to conform to the contract or arrive after the contract time, the buyer may proceed as if there had been casualty to identified goods (section 4-2-613).

Source: L. 65: p. 1316, § 1. **C.R.S. 1963:** § 155-2-324.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. The "no arrival, no sale" term in a "destination" overseas contract leaves risk of loss on the seller but gives him an exemption from liability for non-delivery. Both the nature of the case and the duty of good faith require that the seller must not interfere with the arrival of the goods in any way. If the circumstances impose upon him the responsibility for making or arranging the shipment, he must have a shipment made despite the exemption clause. Further, the shipment made must be a conforming one, for the exemption under a "no arrival, no sale" term applies only to the hazards of transportation and the goods must be proper in all other respects.

The reason of this section is that where the seller is reselling goods bought by him as shipped by another and this fact is known to the buyer, so that the seller is not under any obligation to make the shipment himself, the seller is entitled under the "no arrival, no sale" clause to exemption from payment of damages for non-delivery if the goods do not arrive or if the goods which actually arrive are non-conforming. This does not extend to sellers who arrange shipment by their own agents, in which case the clause is limited to casualty due to marine hazards. But sellers who make known that they are contracting only with respect to what will be delivered to them by parties over whom they assume no control are entitled to the full quantum of the exemption.

2. The provisions of this Article on identification must be read together with the present section in order to bring the exemption into application. Until there is some designation of the goods in a particular shipment or on a particular ship as being those to which the contract refers there can be no application of an exemption for their non-arrival.

3. The seller's duty to tender the agreed or declared goods if they do arrive is not impaired because of their delay in arrival or by their arrival after transshipment.

4. The phrase "to arrive" is often employed in the same sense as "no arrival, no sale" and may then be given the same effect. But a "to arrive" term, added to a C.I.F. or C. & F. contract, does not have the full meaning given by this section to "no arrival, no sale". Such a "to arrive" term is usually intended to operate only to the extent that the risks are not covered by the agreed insurance and the loss or casualty is due to such uncovered hazards. In some instances the "to arrive" term may be regarded as a time of payment term, or, in the case of the reselling seller discussed in point 1 above, as negating responsibility for conformity of the goods, if they arrive, to any description which was based on his good faith belief of the quality. Whether this is the intention of the parties is a question of fact based on all the circumstances surrounding the resale and in case of ambiguity the rules of Sections 2-316 and 2-317 apply to preclude dishonor.

5. Paragraph (b) applies where goods arrive impaired by damage or partial loss during transportation and makes the policy of this Article on casualty to identified goods applicable to such a situation. For the term cannot be regarded as intending to give the seller an unforeseen profit through casualty; it is intended only to protect him from loss due to causes beyond his control.

Cross References:

Point 1: Section 4-1-203.
Point 2: Section 4-2-501(a) and (c).
Point 5: Section 4-2-613.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Conforming". Section 4-2-106.
"Contract". Section 4-1-201.
"Fault". Section 4-1-201.
"Goods". Section 4-2-105.
"Sale". Section 4-2-106.
"Seller". Section 4-2-103.
"Term". Section 4-1-201.

4-2-325. "Letter of credit" - "confirmed credit". (1) Failure of the buyer seasonably to furnish an agreed letter of credit is a breach of the contract for sale.

(2) The delivery to seller of a proper letter of credit suspends the buyer's obligation to

pay. If the letter of credit is dishonored, the seller may on seasonable notification to the buyer require payment directly from him.

(3) Unless otherwise agreed, the term "letter of credit" or "banker's credit" in a contract for sale means an irrevocable credit issued by a financing agency of good repute and, where the shipment is overseas, of good international repute. The term "confirmed credit" means that the credit must also carry the direct obligation of such an agency which does business in the seller's financial market.

Source: L. 65: p. 1316, § 1. **C.R.S. 1963:** § 155-2-325.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To express the established commercial and banking understanding as to the meaning and effects of terms calling for "letters of credit" or "confirmed credit":

1. Subsection (2) follows the general policy of this Article and Article 3 (Section 3-802) on conditional payment, under which payment by check or other short-term instrument is not ordinarily final as between the parties if the recipient duly presents the instrument and honor is refused. Thus the furnishing of a letter of credit does not substitute the financing agency's obligation for the buyer's, but the seller must first give the buyer reasonable notice of his intention to demand direct payment from him.

2. Subsection (2) requires that the credit be irrevocable and be a prime credit as determined by the standing of the issuer. It is not necessary, unless otherwise agreed, that the credit be a negotiation credit; the seller can finance himself by an assignment of the proceeds under Section 5-116(2).

3. The definition of "confirmed credit" is drawn on the supposition that the credit is issued by a bank which is not doing direct business in the seller's financial market; there is no intention to require the obligation of two banks both local to the seller.

Cross References:

Sections 4-2-403, 4-2-511(3) and 3-802 and Article 5.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Contract for sale". Section 4-2-106.
"Draft". Section 4-3-104.
"Financing agency". Section 4-2-104.
"Notifies". Section 4-1-201.
"Overseas". Section 4-2-323.
"Purchaser". Section 4-1-201.
"Seasonably". Section 4-1-204.
"Seller". Section 4-2-103.
"Term". Section 4-1-201.

4-2-326. Sale on approval and sale or return - rights of creditors. (1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is:

(a) A "sale on approval" if the goods are delivered primarily for use; and

(b) A "sale or return" if the goods are delivered primarily for resale.

(2) Goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this article (section 4-2-201) and as contradicting the sale aspect of the contract within the provisions of this article on parol or extrinsic evidence (section 4-2-202).

(4) The provisions of this section shall not apply to the placement of works of fine art on consignment, which shall be governed by the provisions of article 15 of title 6, C.R.S.

Source: L. 65: p. 1317, § 1. **C.R.S. 1963:** § 155-2-326. **L. 82:** (5) added, p. 231, § 2, effective March 25. **L. 2001:** Entire section amended, p. 1436, § 20, effective July 1.

Editor's note - Colorado legislative change: There is no counterpart to subsection (5) in the uniform act. Subsection (5) was renumbered as subsection (4) in 2001.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 19(3), Uniform Sales Act.

Changes: Completely rewritten in this and the succeeding section.

Purposes of Changes: To make it clear that:

1. A "sale on approval" or "sale or return" is distinct from other types of transactions with which they have frequently been confused. The type of "sale on approval," "on trial" or "on satisfaction" dealt with involves a contract under which the seller undertakes a particular business risk to satisfy his prospective buyer with the appearance or performance of the goods in question. The goods are delivered to the proposed purchaser but they remain the property of the seller until the buyer accepts them. The price has already been agreed. The buyer's willingness to receive and test the goods is the consideration for the seller's engagement to deliver and sell. The type of "sale or return" involved herein is a sale to a merchant whose unwillingness to buy is overcome only by the seller's engagement to take back the goods (or any commercial unit of goods) in lieu of payment if they fail to be resold. These two transactions are so strongly delineated in practice and in general understanding that every presumption runs against a delivery to a consumer being a "sale or return" and against a delivery to a merchant for resale being a "sale on approval."

The right to return the goods for failure to conform to the contract does not make the transaction a "sale on approval" or "sale or return" and has nothing to do with this and the following section. The present section is not concerned with remedies for breach of contract. It deals instead with a power given by the contract to turn back the goods even though they are wholly as warranted.

This section nevertheless presupposes that a contract for sale is contemplated by the parties although that contract may be of the peculiar character here described.

Where the buyer's obligation as a buyer is conditioned not on his personal approval but on the article's passing a described objective test, the risk of loss by casualty pending the test is properly the seller's and proper return is at his expense. On the point of "satisfaction" as meaning "reasonable satisfaction" where an industrial machine is involved, this Article takes no position.

2. Pursuant to the general policies of this Act which require good faith not only between the parties to the sales contract, but as against interested third parties, subsection (3) resolves all reasonable doubts as to the nature of the transaction in favor of the general creditors of the buyer. As against such creditors words such as "on consignment" or "on memorandum", with or without words of reservation of title in the seller, are disregarded when the buyer has a place of business at which he deals in goods of the kind involved. A necessary exception is made where the buyer is known to be engaged primarily in selling the goods of others or is selling under a relevant sign law, or the seller complies with the filing provisions of Article 9 as if his interest were a security interest. However, there is no intent in this Section to narrow the protection afforded to third parties in any jurisdiction which has a selling Factors Act. The purpose of the exception is merely to limit the effect of the present subsection itself, in the absence of any such Factors Act, to cases in which creditors of the buyer may reasonably be deemed to have been misled by the secret reservation.

3. Subsection (4) resolves a conflict in the pre-existing case law by recognition that an "or return" provision is so definitely at odds with any ordinary contract for sale of goods that where written agreements are involved it must be contained in a written memorandum. The "or return" aspect of a sales contract must be treated as a separate contract under the Statute of Frauds section and as contradicting the sale insofar as questions of parol or extrinsic evidence are concerned.

Cross References:

Point 2: Article 9.

Point 3: Sections 4-2-201 and 4-2-202.

Definitional Cross References:

"Between merchants". Section 4-2-104.
"Buyer". Section 4-2-103.
"Conform". Section 4-2-106.
"Contract for sale". Section 4-2-106.
"Creditor". Section 4-1-201.
"Goods". Section 4-2-105.
"Sale". Section 4-2-106.
"Seller". Section 4-2-103.

ANNOTATION

I. GENERAL CONSIDERATION.

Law reviews. For article, "Exclusion and Modification of Warranty under the U.C.C. —

How to Succeed in Business Without Being Liable for Not Really Trying", see 46 Den. L.J. 579 (1969). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

II. SALE ON APPROVAL; SALE OR RETURN.

"Sale or return" under subsection (1) is not defined in the Uniform Commercial Code. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

"Sale or return" transaction is not a new concept in Colorado law. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

A "sale or return" is a contract for the sale of goods whereby title passes immediately to the buyer subject to his option to rescind or return the goods if he does not resell them. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

Sale and delivery distinguished from bailment. An option to return a purchase, if one does not approve, is different from an option to purchase, if one does approve. In the former case, the title passes, subject to the right to rescind and return; in the latter, the title does not pass until the option to buy is determined. The former is a sale and delivery, the latter a bailment which may be converted into a sale, at the option of the bailee. Ferry-Morse Seed Co. v. Bd. of County Comm'rs, 126 Colo. 426, 250 P.2d 1003 (1952) (decided under repealed CSA, C. 143A, § 19, uniform sales act).

III. CLAIMS OF BUYER'S CREDITORS.

Subsection (2) provides that goods held on sale or return are subject to the claims of the buyer's creditors while such goods are in the buyer's possession. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

Consignments are subject to the claims of the buyer's creditors. Consignment transactions, in which the owner (consignor) delivers goods to a dealer (consignee) for sale by that dealer, are governed by the "sale or return" provisions of subsection (2), and the goods held on sale or return are subject to the security interests of the consignee's creditors. Am. Nat'l Bank v. Quad Constr., Inc., 31 Colo. App. 373, 504 P.2d 1113 (1972).

The purpose of this section is to allow a creditor of a dealer to attach a lien against property of a third person which is in the dealer's possession on consignment and to permit the creditor to treat such property as if it were owned by the dealer. Am. Nat'l Bank v. Quad Constr., Inc., 31 Colo. App. 373, 504 P.2d 1113 (1972).

Security interest not affected by transfer of possession. A security interest in consigned goods, having attached while the chattels were in consignee's possession, is not affected by a subsequent transfer of possession of the chattels from the consignee to the consignor, the transfer of possession of machines to being in violation of the perfected security interest in the chattels, and the secured party is entitled to recover possession of the goods from consignor or to recover the value of the goods if a return could not be had. Am. Nat'l Bank v. Quad Constr., Inc., 31 Colo. App. 373, 504 P.2d 1113 (1972).

This rule is consistent with the rights of a secured party as they existed prior to the enactment of the uniform commercial code, for, under the chattel mortgage statutes in effect prior to the adoption of the code, the rights of a mortgagee of chattels were superior to the rights of one acquiring possession of the chattels from the mortgagor even where the transfer purported to be absolute and in exclusion of the rights of the mortgagee, and in such cases, the mortgagee could recover the value of the chattels in an action against the transferee for conversion. Am. Nat'l Bank v. Quad Constr., Inc., 31 Colo. App. 373, 504 P.2d 1113 (1972).

Bank, as secondary creditor, had no right to go against the primary creditor's debtor on the theory that collateral on the primary debt was insufficient to cover its secondary debt, and the bank's only action is against its own debtor. Am. Nat'l Bank v. Etter, 32 Colo. App. 187, 508 P.2d 415 (1973).

Fact that prior litigation established bank to be an unsecured creditor as regards its own debtor does not place any liability on the primary creditor's debtor. Am. Nat'l Bank v. Etter, 32 Colo. App. 187, 508 P.2d 415 (1973).

IV. SELLING GOODS OF OTHERS.

Consignment transactions are governed by this section. Consignment transactions, in which the owner (consignor) delivers goods to a dealer (consignee) for sale by that dealer are governed by the "sale or return" provisions of subsection (3), and the goods held on sale or return are subject to the security interests of the consignee's creditors. Am. Nat'l Bank v. Quad

Constr., Inc., 31 Colo. App. 373, 504 P.2d 1113 (1972).

Under the pre-U.C.C. common-law majority rule, the concept of title dictated that a bailee or consignee had no right to hypothecate the property; hence a consignee's creditors would have had no claim against the consignor if the consignee's assets were inadequate to satisfy their respective claims. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970).

The pre-U.C.C. majority rule placed a creditor of the consignee who relied on the consignee's possession in an unfavorable position. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970).

This section of the U.C.C. was enacted to alleviate this problem. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970).

It is noted that Colorado did not follow the pre-U.C.C. majority rule as to the relative rights of the consignor and the creditor of the consignee, for in a pre-code replevin case, it was held that one who placed his goods with a dealer for sale under consignment may not assert his ownership against a judgment creditor of the dealer who levied upon the goods to satisfy his judgment while it was in the dealer's possession. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970).

And this practice was in accord with the concept of apparent title of this section which replaced the concept of title under the pre-U.C.C. majority rule. Am. Nat'l Bank v. Tina Marie Homes. Inc., 28 Colo. App. 477, 476 P.2d 573 (1970).

The purpose of this section is to allow the attachment of a third person's consignment property within a dealer's possession by a creditor of the dealer and to permit the creditor to treat such property as if it were owned by the dealer. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Quad Constr., Inc., 31 Colo. App. 373, 504 P.2d 1113 (1972).

Subsection (3) does not distinguish between general and secured creditors. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

The section refers only to "creditors". Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

The term "creditor" as defined in § 4-1-201(12) is controlling and includes a general creditor, a secured creditor, a lien creditor and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity, and an executor or administrator of an insolvent debtor's or assignor's estate. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

To prevent the complete shift of risk to the consignor, this section provides three ways in which the consignor can protect his interest from the consignee's creditors in subsections (3)(a), (b), and (c). Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970).

The code provides three ways by which a consignor of goods can protect his goods from the creditors of the consignee in subsections (3)(a), (b), (c). Am. Nat'l Bank v. Etter, 28 Colo. App. 511, 476 P.2d 287 (1970).

The exceptions set forth in subsections (3) (a), (b), (c), apply only to transactions covered by subsection (3) and do not apply to a "sale or return" under subsection (1). Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

Consignment transactions. Consignment transactions (i.e., where title does not pass to the consignee) are covered by subsection (3), which deems such a transaction to be a "sale or return", and are subject to the claims of the consignee's creditors, unless one of the three exceptions under subsection (3) is established. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

Consignment versus bailment. Where the purpose of the delivery of an item is to attempt to sell it, and an eventual transfer of title is clearly contemplated by the parties, such a transaction clearly is a consignment and not a bailment, and as such is deemed to be a "sale or return" as set forth in subsection (3). Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970).

The real owner can protect himself by showing that the creditor had no right to assume that the goods were owned by the consignee. Am. Nat'l Bank v. Quad Constr., Inc., 31 Colo. App. 373, 504 P.2d 1113 (1972).

One of several means by which the consignor may protect himself is by showing that the dealer is generally known by his creditors to be substantially engaged in selling the goods of others. Am. Nat'l Bank v. Quad Constr., Inc., 31 Colo. App. 373, 504 P.2d 1113 (1972).

Sufficient evidence. Finding that a dealer "was conducting or was substantially engaged in selling goods of others", within the exception provided by subsection (3)(b), is not conclusive absent a finding that the dealer was "generally known by his creditors" to be substantially engaged in selling the goods of others, and provided there is sufficient evidence to support such a finding. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

A creditor's actual knowledge that a debtor is substantially engaged in selling the goods of others is sufficient to establish the exception provided in subsection (3)(b). Eurpac Serv. Inc. v. Republic Acceptance Corp., 37 P.3d 447 (Colo. App. 2000).

Evidence cannot be based on hearsay. Where the trial court allowed the consignor's witnesses, both creditors and others, to testify that consignee was engaged in selling goods of others but refused to permit these witnesses to testify to conversations with other persons concerning the knowledge of such other persons that consignee was engaged in selling the goods of others, such testimony was properly excluded as hearsay. Am. Nat'l Bank v. Quad Constr., Inc., 31 Colo. App. 373, 504 P.2d 1113 (1972).

Where the creditor properly protects its interest in an item delivered to a dealer by filing according to subsection (3)(c) and the consignor does not comply with this provision, nor otherwise does anything to manifest its interest in the item, the rights of the creditor are superior. Am. Nat'l Bank v. Tina Marie Homes, Inc., 28 Colo. App. 477, 476 P.2d 573 (1970).

Right cannot be circumscribed by estoppel. Since the maxim that "equity follows the law" applies where a legal right is clearly established by a secured party under this section, the equitable doctrine of estoppel cannot be used to circumscribe that right, and the effect of this principle is reinforced where the secured party made no misrepresentation upon which consignor relied to his detriment. Am. Nat'l Bank v. Christensen, 28 Colo. App. 501, 476 P.2d 281 (1970).

Where an item is delivered for sale and the consignor fails to establish any of these exceptions, the application of the code provisions gives a secured party an interest superior to the consignor. Am. Nat'l Bank v. Etter, 28 Colo. App. 511, 476 P.2d 287 (1970).

Where the question of ownership is judicially settled in a buyer's favor, the item can thereafter be loaned to the seller without rendering such subject to attachment by the seller's creditors. Foster v. Howell, 122 Colo. 64, 220 P.2d 717 (1950) (decided under repealed CSA, C. 143A, § 9, uniform sales act).

4-2-327. Special incidents of sale on approval and sale or return. (1) Under a sale on approval, unless otherwise agreed:

(a) Although the goods are identified to the contract, the risk of loss and the title do not pass to the buyer until acceptance; and

(b) Use of the goods consistent with the purpose of trial is not acceptance, but failure seasonably to notify the seller of election to return the goods is acceptance, and if the goods conform to the contract, acceptance of any part is acceptance of the whole; and

(c) After due notification of election to return, the return is at the seller's risk and expense, but a merchant buyer must follow any reasonable instructions.

(2) Under a sale or return, unless otherwise agreed:

(a) The option to return extends to the whole or any commercial unit of the goods while in substantially their original condition, but must be exercised seasonably; and

(b) The return is at the buyer's risk and expense.

Source: L. 65: p. 1317, § 1. **C.R.S. 1963:** § 155-2-327.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 19(3), Uniform Sales Act.

Changes: Completely rewritten in preceding and this section.

Purposes of Changes: To make it clear that:

1. In the case of a sale on approval:

If all of the goods involved conform to the contract, the buyer's acceptance of part of the goods constitutes acceptance of the whole. Acceptance of part falls outside the normal intent of the parties in the "on approval" situation and the policy of this Article allowing partial accep-

tance of a defective delivery has no application here. A case where a buyer takes home two dresses to select one commonly involves two distinct contracts; if not, it is covered by the words "unless otherwise agreed".

2. In the case of a sale or return, the return of any unsold unit merely because it is unsold is the normal intent of the "sale or return" provision, and therefore the right to return for this reason alone is independent of any other action under the contract which would turn on wholly different considerations. On the other hand, where the return of goods is for breach, including return of items resold by the buyer and returned by the ultimate purchasers because of defects, the return procedure is governed not by the present section but by the provisions on the effects and revocation of acceptance.

3. In the case of a sale on approval the risk rests on the seller until acceptance of the goods by the buyer, while in a sale or return the risk remains throughout on the buyer.

4. Notice of election to return given by the buyer in a sale on approval is sufficient to relieve him of any further liability. Actual return by the buyer to the seller is required in the case of a sale or return contract. What constitutes due "giving" of notice, as required in "on approval" sales, is governed by the provisions on good faith and notice. "Seasonable" is used here as defined in Section 1-204. Nevertheless, the provisions of both this Article and of the contract on this point must be read with commercial reason and with full attention to good faith.

Cross References:

Point 1: Sections 4-2-501, 4-2-601 and 4-2-603.

Point 2: Sections 4-2-607 and 4-2-608.

Point 4: Sections 4-1-201 and 4-1-204.

Definitional Cross References:

"Agreed". Section 4-1-201.
"Buyer". Section 4-2-103.
"Commercial unit". Section 4-2-105.
"Conform". Section 4-2-106.
"Contract". Section 4-1-201.
"Goods". Section 4-2-105.
"Merchant". Section 4-2-104.
"Notifies". Section 4-1-201.
"Notification". Section 4-1-201.
"Sale on approval". Section 4-2-326.
"Sale or return". Section 4-2-326.
"Seasonably". Section 4-1-204.
"Seller". Section 4-2-103.

4-2-328. Sale by auction. (1) In a sale by auction if goods are put up in lots each lot is the subject of a separate sale.

(2) A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in other customary manner. Where a bid is made while the hammer is falling in acceptance of a prior bid, the auctioneer may in his discretion reopen the bidding or declare the goods sold under the bid on which the hammer was falling.

(3) Such a sale is with reserve unless the goods are in explicit terms put up without reserve. In an auction with reserve the auctioneer may withdraw the goods at any time until he announces completion of the sale. In an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time. In either case, a bidder may retract his bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid.

(4) If the auctioneer knowingly receives a bid on the seller's behalf or the seller makes or procures such a bid, and notice has not been given that liberty for such bidding is reserved, the buyer may at his option avoid the sale or take the goods at the price of the last good faith bid prior to the completion of the sale. This subsection shall not apply to any bid at a forced sale.

Source: L. 65: p. 1318, § 1. **C.R.S. 1963:** § 155-2-328.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 21, Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes: To make it clear that:

1. The auctioneer may in his discretion either reopen the bidding or close the sale on the bid on which the hammer was falling when a bid is made at that moment. The recognition of a bid of this kind by the auctioneer in his discretion does not mean a closing in favor of such a bidder, but only that the bid has been accepted as a continuation of the bidding. If recognized, such a bid discharges the bid on which the hammer was falling when it was made.

2. An auction "with reserve" is the normal procedure. The crucial point, however, for determining the nature of an auction is the "putting up" of the goods. This Article accepts the

view that the goods may be withdrawn before they are actually "put up," regardless of whether the auction is advertised as one without reserve, without liability on the part of the auction announcer to persons who are present. This is subject to any peculiar facts which might bring the case within the "firm offer" principle of this Article, but an offer to persons generally would require unmistakable language in order to fall within that section. The prior announcement of the nature of the auction either as with reserve or without reserve will, however, enter as an "explicit term" in the "putting up" of the goods and conduct thereafter must be governed accordingly. The present section continues the prior rule permitting withdrawal of bids in auctions both with and without reserve; and the rule is made explicit that the retraction of a bid does not revive a prior bid.

Cross Reference:

Point 2: Section 4-2-205.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Good faith". Section 4-1-201.
"Goods". Section 4-2-105.
"Lot". Section 4-2-105.
"Notice". Section 4-1-201.
"Sale". Section 4-2-106.
"Seller". Section 4-2-103.

PART 4

TITLE, CREDITORS, AND GOOD FAITH PURCHASERS

4-2-401. Passing of title - reservation for security - limited application of this section. Each provision of this article with regard to the rights, obligations, and remedies of the seller, the buyer, purchasers, or other third parties applies irrespective of title to the goods, except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this article and matters concerning title become material, the following rules apply:

(1) Title to goods cannot pass under a contract for sale prior to their identification to the contract (section 4-2-501), and unless otherwise explicitly agreed, the buyer acquires by their identification a special property as limited by this title. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the article on secured transactions (article 9 of this title), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Unless otherwise explicitly agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading:

(a) If the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but

(b) If the contract requires delivery at destination, title passes on tender there.

(3) Unless otherwise explicitly agreed, where delivery is to be made without moving the goods:

(a) If the seller is to deliver a tangible document of title, title passes at the time when and the place where the seller delivers such documents, and if the seller is to deliver an electronic document of title, title passes when the seller delivers the document; or

(b) If the goods are at the time of contracting already identified and no documents of title are to be delivered, title passes at the time and place of contracting.

(4) A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance revests title to the goods in the seller. Such revesting occurs by operation of law and is not a "sale".

(5) Notwithstanding any other provision of this section, when livestock have been delivered under a contract of sale, if on the accompanying brand inspection certificate or memorandum of brand inspection certificate the seller has conspicuously noted that payment of the consideration for the sale has not been received, title does not pass until payment is made.

Source: L. 65: p. 1318, § 1. **C.R.S. 1963:** § 155-2-401. **L. 75:** (5) added, p. 232, § 2, effective June 20. **L. 2006:** (3) amended, p. 491, § 9, effective September 1.

Editor's note - Colorado legislative change. Colorado added subsection (5). There is no counterpart to subsection (5) in the uniform act.

Cross references: For secured transactions, see article 9 of this title.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See generally, Sections 17, 18, 19 and 20, Uniform Sales Act.

Purposes: To make it clear that:

1. This Article deals with the issues between seller and buyer in terms of step by step performance or non-performance under the contract for sale and not in terms of whether or not "title" to the goods has passed. That the rules of this section in no way alter the rights of either the buyer, seller or third parties declared elsewhere in the Article is made clear by the preamble of this section. This section, however, in no way intends to indicate which line of interpretation should be followed in cases where the applicability of "public" regulation depends upon a "sale" or upon location of "title" without further definition. The basic policy of this Article that known purpose and reason should govern interpretation cannot extend beyond the scope of its own provisions. It is therefore necessary to state what a "sale" is and when title passes under this Article in case the courts deem any public regulation to incorporate the defined term of the "private" law.

2. "Future" goods cannot be the subject of a present sale. Before title can pass the goods must be identified in the manner set forth in Section 2-501. The parties, however, have full liberty to arrange by specific terms for the passing of title to goods which are existing.

3. The "special property" of the buyer in goods identified to the contract is excluded from the definition of "security interest"; its incidents are defined in provisions of this Article such as those on the rights of the seller's creditors, on good faith purchase, on the buyer's right to goods on the seller's insolvency, and on the buyer's right to specific performance or replevin.

4. The factual situations in subsections (2) and (3) upon which passage of title turn actually base the test upon the time when the seller has finally committed himself in regard to specific goods. Thus in a "shipment" contract he commits himself by the act of making the shipment. If shipment is not contemplated subsection (3) turns on the seller's final commitment, i.e. the delivery of documents or the making of the contract.

Cross References:

Point 2: Sections 4-2-102, 4-2-501 and 4-2-502.

Point 3: Sections 4-1-201, 4-2-402, 4-2-403, 4-2-502 and 4-2-716.

Definitional Cross References:

"Agreement". Section 4-1-201.
"Bill of lading". Section 4-1-201.
"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Contract for sale". Section 4-2-106.
"Delivery". Section 4-1-201.
"Document of title". Section 4-1-201.
"Good faith". Section 4-2-103.
"Goods". Section 4-2-105.
"Party". Section 4-1-201.
"Purchaser". Section 4-1-201.
"Receipt" of goods. Section 4-2-103.
"Remedy". Section 4-1-201.
"Rights". Section 4-1-201.
"Sale". Section 4-2-106.
"Security interest". Section 4-1-201.
"Seller". Section 4-2-103.
"Send". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Commercial Law", see 58 Den. L.J. 279 (1981).

Annotator's note. Since § 4-2-401 is similar to repealed CRS 53, §§ 17 through 20, and CSA, C. 143A, §§ 17 through 20 (uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

Delivery by the seller to a carrier for shipment to the buyer constitutes delivery to the buyer and the title passes. Denver-Chicago Trucking Co. v. Republic Drug Co., 134 Colo. 461, 306 P.2d 1076 (1957).

Where by the terms of the contract the merchandise to be sold is to be paid for in full upon delivery, the property in the merchandise is not to be transferred to the buyer unless and until payment in full is made by him, and unless this contract is amended, qualified, or in some manner changed, the only way which the buyer could rightfully come into title or property of this merchandise is by payment pursuant to the

terms of the agreement. Panhandle Pipe & Supply Co. v. S. W. Pressey & Son, 25 Colo. 355, 243 P.2d 756 (1952).

Delivery of automobiles sufficient to pass title. Delivery of automobiles to buyer who had made payment by check which subsequently was returned for insufficient funds was sufficient to pass title to the buyer, although the seller failed to provide certificates of title. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 32 Colo. App. 235, 511 P.2d 912 (1973), aff'd, 184 Colo. 166, 519 P.2d 354 (1974).

Failure to deliver bill of sale after giving buyer possession of assets. Where plaintiffs' testimony revealed that it was their intent to sell the business and its assets to the buyer, the failure to deliver the bill of sale after giving the buyer possession of the assets was, at most, a reservation of title, and as such acted as a reservation of a security interest in the property. Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977).

Passage of title to livestock. The livestock bill of sale laws are not superseded by the UCC, and passage of title to livestock in Colorado is accomplished by compliance with article 54 of title 35. When neither party has complied with the livestock bill of sale laws, however, the law merchant, as embodied in the UCC provisions governing passage of title, applies. Rochester Ranch Co. v. Stubblefield, 640 P.2d 267 (Colo. App. 1981); Cugnini v. Reynolds Cattle Co., 648 P.2d 159 (Colo. App. 1981), aff'd, 687 P.2d 962 (Colo. 1984).

Application of UCC provisions to aspects of a livestock transaction other than passage of title is not inconsistent with the additional requirements of compliance with the livestock bill of sale laws. Cugnini v. Reynolds Cattle Co., 648 P.2d 159 (Colo. App. 1981), aff'd, 687 P.2d 962 (Colo. 1984).

Applied in Rancher & Farmers Livestock Auction Co. v. Honey, 38 Colo. App. 69, 552 P.2d 313 (1976); John Deere Indus. Equip. Co. v. Moorehead, 38 Colo. App. 220, 556 P.2d 91 (1976); Mari v. Wagner Equipment Co., Inc., 721 P.2d 1208 (Colo. App. 1986); Brink v. McNeil, 761 P.2d 271 (Colo. App. 1988).

4-2-402. Rights of seller's creditors against sold goods. (1) Except as provided in subsections (2) and (3) of this section, rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods under this article (sections 4-2-502 and 4-2-716).

(2) A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated; except, that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

(3) Nothing in this article shall be deemed to impair the rights of creditors of the seller:

(a) Under the provisions of the article on secured transactions (article 9 of this title); or

(b) Where identification to the contract or delivery is made not in current course of trade but in satisfaction of or as security for a preexisting claim for money, security, or the like and is made under circumstances which under any rule of law of the state where the goods are situated would, apart from this article, constitute the transaction a fraudulent transfer or voidable preference.

Source: L. 65: p. 1320, § 1. **C.R.S. 1963:** § 155-2-402.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (2) — Section 26, Uniform Sales Act; Subsections (1) and (3) — none.

Changes: Rephrased.

Purposes of Changes and New Matter: To avoid confusion on ordinary issues between current sellers and buyers and issues in the field of preference and hindrance by making it clear that:

1. Local law on questions of hindrance of creditors by the seller's retention of possession of the goods are outside the scope of this Article, but retention of possession in the current course of trade is legitimate. Transactions which fall within the law's policy against improper preferences are reserved from the protection of this Article.

2. The retention of possession of the goods by a merchant seller for a commercially reasonable time after a sale or identification in current course is exempted from attack as fraudulent. Similarly, the provisions of subsection (3) have no application to identification or delivery made in the current course of trade, as measured against general commercial understanding of what a "current" transaction is.

Definitional Cross References:

"Contract for sale". Section 4-2-106.

"Creditor". Section 4-1-201.
"Good faith". Section 4-2-103.
"Goods". Section 4-2-105.
"Merchant". Section 4-2-104.
"Money". Section 4-1-201.
"Reasonable time". Section 4-1-204.
"Rights". Section 4-1-201.
"Sale". Section 4-2-106.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Applied in Western Nat'l Bank v. ABC Drilling Co., 42 Colo. App. 407, 599 P.2d 942 (1979).

4-2-403. Power to transfer - good faith purchase of goods - "entrusting". (1) A purchaser of goods acquires all title which his transferor had or had power to transfer; except, that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase, the purchaser has such power even though:

(a) The transferor was deceived as to the identity of the purchaser, or

(b) The delivery was in exchange for a check which is later dishonored, or

(c) It was agreed that the transaction was to be a "cash sale", or

(d) The delivery was procured through fraud punishable as larcenous under the criminal law.

(1.5) Notwithstanding any other provision of this section, when livestock have been delivered under a transaction of purchase and on the accompanying brand inspection certificate or memorandum of brand inspection certificate the seller has conspicuously noted that payment of the consideration for the transaction has not been received, the buyer does not have power to transfer good title to a good faith purchaser for value until payment is made.

(2) Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

(3) "Entrusting" includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor's disposition of the goods have been such as to be larcenous under the criminal law.

(4) The rights of other purchasers of goods and of lien creditors are governed by the articles on secured transactions (article 9 of this title) and documents of title (article 7 of this title).

Source: L. 65: p. 1320, § 1. **C.R.S. 1963:** § 155-2-403. **L. 75:** (1.5) added, p. 232, § 3, effective June 20. **L. 91:** (4) amended, p. 270, § 4, effective July 1.

Editor's note - Colorado legislative change: Colorado added subsection (1.5). There is no counterpart to subsection (1.5) in the uniform act. Colorado adopted Revised Article 6 - Bulk Sales (Alternative B) which was repealed in 1991 and the corresponding reference to "bulk sales" was deleted in subsection (4) in 1991.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 20(4), 23, 24, 25, Uniform Sales Act; Section 9, especially 9(2), Uniform Trust Receipts Act; Section 9, Uniform Conditional Sales Act.
Changes: Consolidated and rewritten.
Purposes of Changes: To gather together a series of prior uniform statutory provisions and the case-law thereunder and to state a unified and simplified policy on good faith purchase of goods.

1. The basic policy of our law allowing transfer of such title as the transferor has is generally continued and expanded under subsection (1). In this respect the provisions of the

section are applicable to a person taking by any form of "purchase" as defined by this Act. Moreover the policy of this Act expressly providing for the application of supplementary general principles of law to sales transactions wherever appropriate joins with the present section to continue unimpaired all rights acquired under the law of agency or of apparent agency or ownership or other estoppel, whether based on statutory provisions or on case law principles. The section also leaves unimpaired the powers given to selling factors under the earlier Factors Acts. In addition subsection (1) provides specifically for the protection of the good faith purchaser for value in a number of specific situations which have been troublesome under prior law.

On the other hand, the contract of purchase is of course limited by its own terms as in a case of pledge for a limited amount or of sale of a fractional interest in goods.

2. The many particular situations in which a buyer in ordinary course of business from a dealer has been protected against reservation of property or other hidden interest are gathered by subsections (2)-(4) into a single principle protecting persons who buy in ordinary course out of inventory. Consignors have no reason to complain, nor have lenders who hold a security interest in the inventory, since the very purpose of goods in inventory is to be turned into cash by sale.

The principle is extended in subsection (3) to fit with the abolition of the old law of "cash sale" by subsection (1)(c). It is also freed from any technicalities depending on the extended law of larceny; such extension of the concept of theft to include trick, particular types of fraud, and the like is for the purpose of helping conviction of the offender; it has no proper application to the long-standing policy of civil protection of buyers from persons guilty of such trick or fraud. Finally, the policy is extended, in the interest of simplicity and sense, to any entrusting by a bailor; this is in consonance with the explicit provisions of Section 7-205 on the powers of a warehouseman who is also in the business of buying and selling fungible goods of the kind he warehouses. As to entrusting by a secured party, subsection (2) is limited by the more specific provisions of Section 9-307(1), which deny protection to a person buying farm products from a person engaged in farming operations.

3. The definition of "buyer in ordinary course of business" (Section 1-201) is effective here and preserves the essence of the healthy limitations engrafted by the case-law on the older statutes. The older loose concept of good faith and wide definition of value combined to create apparent good faith purchasers in many situations in which the result outraged common sense; the court's solution was to protect the original title especially by use of "cash sale" or of over-technical construction of the enabling clauses of the statutes. But such rulings then turned into limitations on the proper protection of buyers in the ordinary market. Section 1-201(9) cuts down the category of buyer in ordinary course in such fashion as to take care of the results of the cases, but with no price either in confusion or in injustice to proper dealings in the normal market.

4. Except as provided in subsection (1), the rights of purchasers other than buyers in ordinary course are left to the Articles on Secured Transactions, Documents of Title, and Bulk Sales.

Cross References:

Point 1: Sections 4-1-103 and 4-1-201.

Point 2: Sections 4-1-201, 4-2-402, 7-205 and 9-307(1).

Points 3 and 4: Sections 1-102, 4-1-201, 4-2-104, 4-2-707 and Articles 6, 7 and 9.

Definitional Cross References:

"Buyer in ordinary course of business". Section 4-1-201.

"Good faith". Sections 4-1-201 and 4-2-103.

"Goods". Section 4-2-105.

"Person". Section 4-1-201.

"Purchaser". Section 4-1-201.

"Signed". Section 4-1-201.

"Term". Section 4-1-201.

"Value". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Commercial Law", see 58 Den. L.J. 279 (1981).

Annotator's note. Since § 4-2-403 is similar to repealed § 121-1-24, CRS 53, and CSA, C. 143A, § 23 (uniform sales act), cases construing this provision have been included in the annotations to this section.

Section conflicts with § 18-4-405 which holds that a good faith purchaser of stolen property does not divest the original owner of his or her right to the property. UCC section prevails because it was later in time and because original owner was in a better position to protect his or her interests than the subsequent good faith purchaser. West v. Roberts, 143 P.3d 1037 (Colo. 2006).

The concept of good faith purchaser for value does not require that the purchaser buy from a merchant or dealer. West v. Roberts, 143 P.3d 1037 (Colo. 2006).

The test of a bona fide purchaser is purchase without notice of the defect in the title of the person from whom he purchased and with-

out notice of the right of the original seller to avoid or rescind the sale. General Credit Corp. v. Bill Olsen's Motor, Inc., 147 Colo. 227, 363 P.2d 489 (1961).

Mere possession of personalty fraudulently obtained was held not alone enough to protect a good faith purchaser against the demands of the defrauded owner where the authorities indicated that possession had to be accompanied by indicia of title. Panhandle Pipe & Supply Co. v. S. W. Pressey & Son, 125 Colo. 355, 243 P.2d 756 (1952).

Effect of right to reclaim on title. The right to reclaim goods sold in a cash sale transaction is a right to undo that transaction; until reclamation is completed, title, as well as the power to pass good title, remains in the purchaser. Ranchers & Farmers Livestock Auction Co. v. Honey, 38 Colo. App. 69, 552 P.2d 313, cert. dismissed, 191 Colo. 503, 553 P.2d 799 (1976).

The voidable title which a purchaser receives when payment is made by check is dependent upon the seller's power to transfer an interest in the goods conveyed. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Lender receives enforceable right to security interest as purchaser. Unless there is some showing of conduct amounting to bad faith, a lender receives an enforceable right to its security interest as a purchaser, even though the seller of the security interest has only a voidable title to the underlying goods. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

After certificates of title of some automobiles were delivered to a bank, the purchaser acquired a voidable title and could convey an enforceable right in the automobile to the lending bank as a good faith purchaser for value, even though check to the seller was later dishonored. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Purchaser clothed with voidable title on proper transfer of title certificates. Where before the seller presented the purchaser's check for collection, the certificates of title to automobiles were delivered to a bank as security for the bank's loan to the purchaser, in accordance with a security agreement between the purchaser and bank, it could be implied that the bank took possession of the certificates of title as the purchaser's agent. At the moment the seller delivered the certificates of title to the purchaser, through the bank as its agent, the requirements of § 42-6-108 were satisfied. Moreover, once the certificates of title were properly transferred, the purchaser was clothed with voidable title and could legally encumber the automobiles. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Leaving property with a merchant who customarily sells that kind of goods clothes the merchant with either apparent ownership or apparent authority to sell the goods. The overall policy underlying this provision is to restrict impediments to the free flow of commerce when buyers in the ordinary course of business are involved. Keybank, Nat'l Ass'n v. Mascarenas, 17 P.3d 209 (Colo. App. 2000).

When an entrustment occurs within the meaning of the statute, the fact that the entrustee procured the entrustment through larceny, trick, or fraud punishable under the criminal law does not defeat the ability of a merchant-trustee to transfer title to the goods to a buyer in the ordinary course of business. Keybank, Nat'l Ass'n v. Mascarenas, 17 P.3d 209 (Colo. App. 2000).

Applied in Rochester Ranch Co. v. Stubblefield, 640 P.2d 267 (Colo. App. 1981); Cugnini v. Reynolds Cattle Co., 648 P.2d 159 (Colo. App. 1981), aff'd, 687 P.2d 962 (Colo. 1984).

PART 5

PERFORMANCE

4-2-501. Insurable interest in goods - manner of identification of goods. (1) The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers, even though the goods so identified are nonconforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement, identification occurs:

(a) When the contract is made if it is for the sale of goods already existing and identified;

(b) If the contract is for the sale of future goods other than those described in paragraph (c) of this subsection, when goods are shipped, marked, or otherwise designated by the seller as goods to which the contract refers; or

(c) When the crops are planted or otherwise become growing crops or the young are conceived, if the contract is for the sale of unborn young to be born within twelve months

after contracting or for the sale of crops to be harvested within twelve months or the next normal harvest season after contracting, whichever is longer.

(2) The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains in him, and where the identification is by the seller alone, he may until default or insolvency or notification to the buyer that the identification is final substitute other goods for those identified.

(3) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

Source: L. 65: p. 1321, § 1. **C.R.S. 1963:** § 155-2-501.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See Sections 17 and 19, Uniform Sales Act.

Purposes:

1. The present section deals with the manner of identifying goods to the contract so that an insurable interest in the buyer and the rights set forth in the next section will accrue. Generally speaking, identification may be made in any manner "explicitly agreed to" by the parties. The rules of paragraphs (a), (b) and (c) apply only in the absence of such "explicit agreement".

2. In the ordinary case identification of particular existing goods as goods to which the contract refers is unambiguous and may occur in one of many ways. It is possible, however, for the identification to be tentative or contingent. In view of the limited effect given to identification by this Article, the general policy is to resolve all doubts in favor of identification.

3. The provision of this section as to "explicit agreement" clarifies the present confusion in the law of sales which has arisen from the fact that under prior uniform legislation all rules of presumption with reference to the passing of title or to appropriation (which in turn depended upon identification) were regarded as subject to the contrary intention of the parties or of the party appropriating. Such uncertainty is reduced to a minimum under this section by requiring "explicit agreement" of the parties before the rules of paragraphs (a), (b) and (c) are displaced-as they would be by a term giving the buyer power to select the goods. An "explicit" agreement, however, need not necessarily be found in the terms used in the particular transaction. Thus, where a usage of the trade has previously been made explicit by reduction to a standard set of "rules and regulations" currently incorporated by reference into the contracts of the parties, a relevant provision of those "rules and regulations" is "explicit" within the meaning of this section.

4. In view of the limited function of identification there is no requirement in this section that the goods be in deliverable state or that all of the seller's duties with respect to the processing of the goods be completed in order that identification occur. For example, despite identification the risk of loss remains on the seller under the risk of loss provisions until completion of his duties as to the goods and all of his remedies remain dependent upon his not defaulting under the contract.

5. Undivided shares in an identified fungible bulk, such as grain in an elevator or oil in a storage tank, can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough under subsection (a) to effect an identification if there is no explicit agreement otherwise. The seller's duty, however, to segregate and deliver according to the contract is not affected by such an identification but is controlled by other provisions of this Article.

6. Identification of crops under paragraph (c) is made upon planting only if they are to be harvested within the year or within the next normal harvest season. The phrase "next normal harvest season" fairly includes nursery stock raised for normally quick "harvest," but plainly excludes a "timber" crop to which the concept of a harvest "season" is inapplicable.

Paragraph (c) is also applicable to a crop of wool or the young of animals to be born within twelve months after contracting. The product of a lumbering, mining or fishing operation, though seasonal, is not within the concept of "growing". Identification under a contract for all or part of the output of such an operation can be effected early in the operation.

Cross References:

Point 1: Section 4-2-502.

Point 4: Sections 4-2-509, 4-2-510 and 4-2-703.

Point 5: Sections 4-2-105, 4-2-308, 4-2-503 and 4-2-509.

Point 6: Sections 4-2-105(1), 4-2-107(1) and 4-2-402.

Definitional Cross References:

"Agreement". Section 4-1-201.

"Contract". Section 4-1-201.

"Contract for sale". Section 4-2-106.

"Future goods". Section 4-2-105.

"Goods". Section 4-2-105.

"Notification". Section 4-1-201.

"Party". Section 4-1-201.
"Sale". Section 4-2-106.
"Security interest". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Identification of fungible goods in a contract for the sale of goods already existing and identified occurs at the time of contract, so this is sufficient to satisfy the statute and allow the seller to recover under the contract. Great Western Sugar v. Pennant Prods., 748 P.2d 1359 (Colo. App. 1987).

Applied in Mari v. Wagner Equipment Co., Inc., 721 P.2d 1208 (Colo. App. 1986).

4-2-502. Buyer's right to goods on seller's insolvency - repudiation - failure to deliver. (1) Subject to subsections (2) and (3) of this section and even though the goods have not been shipped, a buyer who has paid a part or all of the price of goods in which he or she has a special property under the provisions of section 4-2-501 may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if:

(a) In the case of goods bought for personal, family, or household purposes, the seller repudiates or fails to deliver as required by the contract; or

(b) In all cases, the seller becomes insolvent within ten days after receipt of the first installment on their price.

(2) The buyer's right to recover the goods under paragraph (a) of subsection (1) of this section vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

(3) If the identification creating his or her special property has been made by the buyer, he or she acquires the right to recover the goods only if they conform to the contract for sale.

Source: L. 65: p. 1322, § 1. **C.R.S. 1963:** § 155-2-502. **L. 2001:** Entire section amended, p. 1437, § 21, effective July 1.

Cross references: For insurable interest in goods, see § 4-2-501; for secured transactions, see article 9 of this title.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Compare Sections 17, 18 and 19, Uniform Sales Act.

Purposes:

1. This section gives an additional right to the buyer as a result of identification of the goods to the contract in the manner provided in Section 2-501. The buyer is given a right to the goods on the seller's insolvency occurring within 10 days after he receives the first installment on their price.

2. The question of whether the buyer also acquires a security interest in identified goods and has rights to the goods when insolvency takes place after the ten-day period provided in this section depends upon compliance with the provisions of the Article on Secured Transactions (Article 9).

3. Subsection (2) is included to preclude the possibility of unjust enrichment which exists if the buyer were permitted to recover goods even though they were greatly superior in quality or quantity to that called for by the contract for sale.

Cross References:

Point 1: Sections 4-1-201 and 4-2-702.
Point 2: Article 9.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Conform". Section 4-2-106.
"Contract for sale". Section 4-2-106.
"Goods". Section 4-2-105.
"Insolvent". Section 4-1-201.
"Rights". Section 4-1-201.
"Seller". Section 4-2-103.

4-2-503. Manner of seller's tender of delivery. (1) Tender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery. The manner, time, and place for tender are determined by the agreement and this article, and in particular:

(a) Tender must be at a reasonable hour, and if it is of goods they must be kept available for the period reasonably necessary to enable the buyer to take possession; but

(b) Unless otherwise agreed, the buyer must furnish facilities reasonably suited to the receipt of the goods.

(2) Where the case is within section 4-2-504 respecting shipment, tender requires that the seller comply with its provisions.

(3) Where the seller is required to deliver at a particular destination, tender requires that he comply with subsection (1) of this section and also in any appropriate case tender documents as described in subsections (4) and (5) of this section.

(4) Where goods are in the possession of a bailee and are to be delivered without being moved:

(a) Tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the buyer's right to possession of the goods; but

(b) Tender to the buyer of a nonnegotiable document of title or of a record directing the bailee to deliver is sufficient tender unless the buyer seasonably objects, and except as otherwise provided in article 9 of this title, receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the nonnegotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

(5) Where the contract requires the seller to deliver documents:

(a) He must tender all such documents in correct form, except as provided in this article with respect to bills of lading in a set (subsection (2) of section 4-2-323); and

(b) Tender through customary banking channels is sufficient and dishonor of a draft accompanying or associated with the documents constitutes nonacceptance or rejection.

Source: L. 65: p. 1322, § 1. **C.R.S. 1963:** § 155-2-503. **L. 2006:** (4)(b) and (5)(b) amended, p. 491, § 10, effective September 1.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See Sections 11, 19, 20, 43(3) and (4), 46 and 51, Uniform Sales Act.

Changes: The general policy of the above sections is continued and supplemented but subsection (3) changes the rule of prior section 19(5) as to what constitutes a "destination" contract and subsection (4) incorporates a minor correction as to tender of delivery of goods in the possession of a bailee.

Purposes of Changes:

1. The major general rules governing the manner of proper or due tender of delivery are gathered in this section. The term "tender" is used in this Article in two different senses. In one sense it refers to "due tender" which contemplates an offer coupled with a present ability to fulfill all the conditions resting on the tendering party and must be followed by actual performance if the other party shows himself ready to proceed. Unless the context unmistakably indicates otherwise this is the meaning of "tender" in this Article and the occasional addition of the word "due" is only for clarity and emphasis. At other times it is used to refer to an offer of goods or documents under a contract as if in fulfillment of its conditions even though there is a defect when measured against the contract obligation. Used in either sense, however, "tender" connotes such performance by the tendering party as puts the other party in default if he fails to proceed in some manner.

2. The seller's general duty to tender and deliver is laid down in Section 2-301 and more particularly in Section 2-507. The seller's right to a receipt if he demands one and receipts are customary is governed by Section 1-205. Subsection (1) of the present section proceeds to set forth two primary requirements of tender: first, that the seller "put and hold conforming goods at the buyer's disposition" and, second, that he "give the buyer any notice reasonably necessary to enable him to take delivery."

In cases in which payment is due and demanded upon delivery the "buyer's disposition" is qualified by the seller's right to retain control of the goods until payment by the provision of this Article on delivery on condition. However, where the seller is demanding payment on delivery he must first allow the buyer to inspect the goods in order to avoid impairing his tender unless the contract for sale is on C.I.F., C.O.D., cash against documents or similar terms negating the privilege of inspection before payment.

In the case of contracts involving documents the seller can "put and hold conforming goods at the buyer's disposition" under subsection (1) by tendering documents which give the buyer

complete control of the goods under the provisions of Article 7 on due negotiation.

3. Under paragraph (a) of subsection (1) usage of the trade and the circumstances of the particular case determine what is a reasonable hour for tender and what constitutes a reasonable period of holding the goods available.

4. The buyer must furnish reasonable facilities for the receipt of the goods tendered by the seller under subsection (1), paragraph (b). This obligation of the buyer is no part of the seller's tender.

5. For the purposes of subsections (2) and (3) there is omitted from this Article the rule under prior uniform legislation that a term requiring the seller to pay the freight or cost of transportation to the buyer is equivalent to an agreement by the seller to deliver to the buyer or at an agreed destination. This omission is with the specific intention of negating the rule, for under this Article the "shipment" contract is regarded as the normal one and the "destination" contract as the variant type. The seller is not obligated to deliver at a named destination and bear the concurrent risk of loss until arrival, unless he has specifically agreed so to deliver or the commercial understanding of the terms used by the parties contemplates such delivery.

6. Paragraph (a) of subsection (4) continues the rule of the prior uniform legislation as to acknowledgment by the bailee. Paragraph (b) of subsection (4) adopts the rule that between the buyer and the seller the risk of loss remains on the seller during a period reasonable for securing acknowledgment of the transfer from the bailee, while as against all other parties the buyer's rights are fixed as of the time the bailee receives notice of the transfer.

7. Under subsection (5) documents are never "required" except where there is an express contract term or it is plainly implicit in the peculiar circumstances of the case or in a usage of trade. Documents may, of course, be "authorized" although not required, but such cases are not within the scope of this subsection. When documents are required, there are three main requirements of this subsection: (1) "All": each required document is essential to a proper tender; (2) "Such": the documents must be the ones actually required by the contract in terms of source and substance; (3) "Correct form": All documents must be in correct form.

When a prescribed document cannot be procured, a question of fact arises under the provision of this Article on substituted performance as to whether the agreed manner of delivery is actually commercially impracticable and whether the substitute is commercially reasonable.

Cross References:

Point 2: Sections 4-1-205, 4-2-301, 4-2-310, 4-2-507 and 4-2-513 and Article 7.

Point 5: Sections 4-2-308, 4-2-310 and 4-2-509.

Point 7: Section 4-2-614(1).

Specific matters involving tender are covered in many additional sections of this Article. See Sections 4-1-205, 4-2-301, 4-2-306 to 4-2-319, 4-2-321(3), 4-2-504, 4-2-507(2), 4-2-511(1), 4-2-513, 4-2-612 and 4-2-614.

Definitional Cross References:

"Agreement". Section 4-1-201.
"Bill of lading". Section 4-1-201.
"Buyer". Section 4-2-103.
"Conforming". Section 4-2-106.
"Contract". Section 4-1-201.
"Delivery". Section 4-1-201.
"Dishonor". Section 3-508.
"Document of title". Section 4-1-201.
"Draft". Section 4-3-104.
"Goods". Section 4-2-105.
"Notification". Section 4-1-201.
"Reasonable time". Section 4-1-204.
"Receipt" of goods. Section 4-2-103.
"Rights". Section 4-1-201.
"Seasonably". Section 4-1-204.
"Seller". Section 4-2-103.
"Written". Section 4-1-201.

4-2-504. Shipment by seller. Where the seller is required or authorized to send the goods to the buyer and the contract does not require him to deliver them at a particular destination, then, unless otherwise agreed, he must:

(a) Put the goods in the possession of such a carrier and make such a contract for their transportation as may be reasonable, having regard to the nature of the goods and other circumstances of the case; and

(b) Obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade; and

(c) Promptly notify the buyer of the shipment. Failure to notify the buyer under subsection (c) of this section or to make a proper contract under subsection (a) of this section is a ground for rejection only if material delay or loss ensues.

Source: L. 65: p. 1323, § 1. **C.R.S. 1963:** § 155-2-504.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 46, Uniform Sales Act.
Changes: Rewritten.
Purposes of Changes: To continue the general policy of the prior uniform statutory provision while incorporating certain modifications with respect to the requirement that the contract with the carrier be made expressly on behalf of the buyer and as to the necessity of giving notice of the shipment to the buyer, so that:

1. The section is limited to "shipment" contracts as contrasted with "destination" contracts or contracts for delivery at the place where the goods are located. The general principles embodied in this section cover the special cases of F.O.B. point of shipment contracts and C.I.F. and C. & F. contracts. Under the preceding section on manner of tender of delivery, due tender by the seller requires that he comply with the requirements of this section in appropriate cases.

2. The contract to be made with the carrier under paragraph (a) must conform to all express terms of the agreement, subject to any substitution necessary because of failure of agreed facilities as provided in the later provision on substituted performance. However, under the policies of this Article on good faith and commercial standards and on buyer's rights on improper delivery, the requirements of explicit provisions must be read in terms of their commercial and not their literal meaning. This policy is made express with respect to bills of lading in a set in the provision of this Article on form of bills of lading required in overseas shipment.

3. In the absence of agreement, the provision of this Article on options and cooperation respecting performance gives the seller the choice of any reasonable carrier, routing and other arrangements. Whether or not the shipment is at the buyer's expense the seller must see to any arrangements, reasonable in the circumstances, such as refrigeration, watering of live stock, protection against cold, the sending along of any necessary help, selection of specialized cars and the like for paragraph (a) is intended to cover all necessary arrangements whether made by contract with the carrier or otherwise. There is, however, a proper relaxation of such requirements if the buyer is himself in a position to make the appropriate arrangements and the seller gives him reasonable notice of the need to do so. It is an improper contract under paragraph (a) for the seller to agree with the carrier to a limited valuation below the true value and thus cut off the buyer's opportunity to recover from the carrier in the event of loss, when the risk of shipment is placed on the buyer by his contract with the seller.

4. Both the language of paragraph (b) and the nature of the situation it concerns indicate that the requirement that the seller must obtain and deliver promptly to the buyer in due form any document necessary to enable him to obtain possession of the goods is intended to cumulate with the other duties of the seller such as those covered in paragraph (a).

In this connection, in the case of pool car shipments a delivery order furnished by the seller on the pool car consignee, or on the carrier for delivery out of a larger quantity, satisfies the requirements of paragraph (b) unless the contract requires some other form of document.

5. This Article, unlike the prior uniform statutory provision, makes it the seller's duty to notify the buyer of shipment in all cases. The consequences of his failure to do so, however, are limited in that the buyer may reject on this ground only where material delay or loss ensues.

A standard and acceptable manner of notification in open credit shipments is the sending of an invoice and in the case of documentary contracts is the prompt forwarding of the documents as under paragraph (b) of this section. It is also usual to send on a straight bill of lading but this is not necessary to the required notification. However, should such a document prove necessary or convenient to the buyer, as in the case of loss and claim against the carrier, good faith would require the seller to send it on request.

Frequently the agreement expressly requires prompt notification as by wire or cable. Such a term may be of the essence and the final clause of paragraph (c) does not prevent the parties from making this a particular ground for rejection. To have this vital and irreparable effect upon the seller's duties, such a term should be part of the "dickered" terms written in any "form," or should otherwise be called seasonably and sharply to the seller's attention.

6. Generally, under the final sentence of the section, rejection by the buyer is justified only when the seller's dereliction as to any of the requirements of this section in fact is followed by material delay or damage. It rests on the seller, so far as concerns matters not within the peculiar knowledge of the buyer, to establish that his error has not been followed by events which justify rejection.

Cross References:

Point 1: Sections 4-2-319, 4-2-320 and 4-2-503(2).

Point 2: Sections 4-1-203, 4-2-323(2), 4-2-601 and 4-2-614(1).

Point 3: Section 4-2-311(2).

Point 5: Section 4-1-203.

Definitional Cross References:

"Agreement". Section 4-1-201.

"Buyer". Section 4-2-103.

"Contract". Section 4-1-201.

"Delivery". Section 4-1-201.
"Goods". Section 4-2-105.
"Notifies". Section 4-1-201.
"Seller". Section 4-2-103.
"Send". Section 4-1-201.
"Usage of trade". Section 4-1-205.

4-2-505. Seller's shipment under reservation. (1) Where the seller has identified goods to the contract by or before shipment:

(a) His procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller's expectation of transferring that interest to the person named.

(b) A nonnegotiable bill of lading to the seller or the seller's nominee reserves possession of the goods as security, but except in a case of conditional delivery (subsection (2) of section 4-2-507), a nonnegotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession or control of the bill of lading.

(2) When shipment by the seller with reservation of a security interest is in violation of the contract for sale, it constitutes an improper contract for transportation within section 4-2-504, but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the seller's powers as a holder of a negotiable document of title.

Source: L. 65: p. 1323, § 1. **C.R.S. 1963:** § 155-2-505. **L. 2006:** (1)(b) and (2) amended, p. 492, § 11, effective September 1.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 20(2), (3), (4), Uniform Sales Act.

Changes: Completely rephrased, the "powers" of the parties in cases of reservation being emphasized primarily rather than the "rightfulness" of reservation.

Purposes of Changes: To continue in general the policy of the prior uniform statutory provision with certain modifications of emphasis and language, so that:

1. The security interest reserved to the seller under subsection (1) is restricted to securing payment or performance by the buyer and the seller is strictly limited in his disposition and control of the goods as against the buyer and third parties. Under this Article, the provision as to the passing of interest expressly applies "despite any reservation of security title" and also provides that the "rights, obligations and remedies" of the parties are not altered by the incidence of title generally. The security interest, therefore, must be regarded as a means given to the seller to enforce his rights against the buyer which is unaffected by and in turn does not affect the location of title generally. The rules set forth in subsection (1) are not to be altered by any apparent "contrary intent" of the parties as to passing of title, since the rights and remedies of the parties to the contract of sale, as defined in this Article, rest on the contract and its performance or breach and not on stereotyped presumptions as to the location of title.

This Article does not attempt to regulate local procedure in regard to the effective maintenance of the seller's security interest when the action is in replevin by the buyer against the carrier.

2. Every shipment of identified goods under a negotiable bill of lading reserves a security interest in the seller under subsection (1) paragraph (a).

It is frequently convenient for the seller to make the bill of lading to the order of a nominee such as his agent at destination, the financing agency to which he expects to negotiate the document or the bank issuing a credit to him. In many instances, also, the buyer is made the order party. This Article does not deal directly with the question as to whether a bill of lading made out by the seller to the order of a nominee gives the carrier notice of any rights which the nominee may have so as to limit its freedom or obligation to honor the bill of lading in the hands of the seller as the original shipper if the expected negotiation fails. This is dealt with in the Article on Documents of Title (Article 7).

3. A non-negotiable bill of lading taken to a party other than the buyer under subsection (1) paragraph (b) reserves possession of the goods as security in the seller but if he seeks to withhold the goods improperly the buyer can tender payment and recover them.

4. In the case of a shipment by non-negotiable bill of lading taken to a buyer, the seller, under subsection (1) retains no security interest or possession as against the buyer and by the shipment he **de facto** loses control as against the carrier except where he rightfully and effectively stops delivery in transit. In cases in which

the contract gives the seller the right to payment against delivery, the seller, by making an immediate demand for payment, can show that his delivery is conditional, but this does not prevent the buyer's power to transfer full title to a sub-buyer in ordinary course or other purchaser under Section 2-403.

5. Under subsection (2) an improper reservation by the seller which would constitute a breach in no way impairs such of the buyer's rights as result from identification of the goods. The security title reserved by the seller under subsection (1) does not protect his holding of the document or the goods for the purpose of exacting more than is due him under the contract.

Cross References:

Point 1: Section 4-1-201.
Point 2: Article 7.
Point 3: Sections 4-2-501(2) and 4-2-504.
Point 4: Sections 4-2-403, 4-2-507(2) and 4-2-705.
Point 5: Sections 4-2-310, 4-2-319(4), 4-2-320(4), 4-2-501 and 4-2-502 and Article 7.

Definitional Cross References:

"Bill of lading". Section 4-1-201.
"Buyer". Section 4-2-103.
"Consignee". Section 7-102.
"Contract". Section 4-1-201.
"Contract for sale". Section 4-2-106.
"Delivery". Section 4-1-201.
"Financing agency". Section 4-2-104.
"Goods". Section 4-2-105.
"Holder". Section 4-1-201.
"Person". Section 4-1-201.
"Security interest". Section 4-1-201.
"Seller". Section 4-2-103.

4-2-506. Rights of financing agency. (1) A financing agency by paying or purchasing for value a draft which relates to a shipment of goods acquires to the extent of the payment or purchase and in addition to its own rights under the draft and any document of title securing it, any rights of the shipper in the goods including the right to stop delivery and the shipper's right to have the draft honored by the buyer.

(2) The right to reimbursement of a financing agency that has in good faith honored or purchased the draft under commitment to or authority from the buyer is not impaired by subsequent discovery of defects with reference to any relevant document that was apparently regular.

Source: L. 65: p. 1324, § 1. **C.R.S. 1963:** § 155-2-506. **L. 2006:** (2) amended, p. 492, § 12, effective September 1.

OFFICIAL COMMENT

1. "Financing agency" is broadly defined in this Article to cover every normal instance in which a party aids or intervenes in the financing of a sales transaction. The term as used in subsection (1) is not in any sense intended as a limitation and covers any other appropriate situation which may arise outside the scope of the definition.

2. "Paying" as used in subsection (1) is typified by the letter of credit, or "authority to pay" situation in which a banker, by arrangement with the buyer or other consignee, pays on his behalf a draft for the price of the goods. It is immaterial whether the draft is formally drawn on the party paying or his principal, whether it is a sight draft paid in cash or a time draft "paid" in the first instance by acceptance, or whether the payment is viewed as absolute or conditional. All of these cases constitute "payment" under this subsection. Similarly, "purchasing for value" is used to indicate the whole area of financing by the seller's banker, and the principle of subsection (1) is applicable without any niceties of distinction between "purchase," "discount," "advance against collection" or the like. But it is important to notice that the only right to have the draft honored that is acquired is that **against the buyer**; if any right against any one else is claimed it will have to be under some separate obligation of that other person. A letter of credit does not necessarily protect **purchasers** of drafts. See Article 5. And for the relations of the parties to documentary drafts see Part 5 of Article 4.

3. Subsection (1) is made applicable to payments or advances against a draft which "relates to" a shipment of goods and this has been chosen as a term of maximum breadth. In particular the term is intended to cover the case of a draft against an invoice or against a delivery order. Further, it is unnecessary that there be an explicit assignment of the invoice attached to the draft to bring the transaction within the reason of this subsection.

4. After shipment, "the rights of the shipper in the goods" are merely security rights and are subject to the buyer's right to force delivery upon tender of the price. The rights acquired by the financing agency are similarly limited and, moreover, if the agency fails to procure any outstanding negotiable document of title, it may find its exercise of these rights hampered or even defeated by the seller's disposition of the document to a third party. This section does not

attempt to create any new rights in the financing agency against the carrier which would force the latter to honor a stop order from the agency, a stranger to the shipment, or any new rights against a holder to whom a document of title has been duly negotiated under Article 7.

Cross References:

Point 1: Section 4-2-104(2) and Article 4.

Point 2: Part 5 of Article 4, and Article 5.

Point 4: Sections 4-2-501 and 4-2-502(1) and Article 7.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Document of title". Section 4-1-201.
"Draft". Section 4-3-104.
"Financing agency". Section 4-2-104.
"Good faith". Section 4-2-103.
"Goods". Section 4-2-105.
"Honor". Section 4-1-201.
"Purchase". Section 4-1-201.
"Rights". Section 4-1-201.
"Value". Section 4-1-201.

4-2-507. Effect of seller's tender - delivery on condition. (1) Tender of delivery is a condition to the buyer's duty to accept the goods and, unless otherwise agreed, to his duty to pay for them. Tender entitles the seller to acceptance of the goods and to payment according to the contract.

(2) Where payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due.

Source: L. 65: p. 1324, § 1. **C.R.S. 1963:** § 155-2-507.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See Sections 11, 41, 42 and 69, Uniform Sales Act.

Purposes: -

1. Subsection (1) continues the policies of the prior uniform statutory provisions with respect to tender and delivery by the seller. Under this Article the same rules in these matters are applied to present sales and to contracts for sale. But the provisions of this subsection must be read within the framework of the other sections of this Article which bear upon the question of delivery and payment.

2. The "unless otherwise agreed" provision of subsection (1) is directed primarily to cases in which payment in advance has been promised or a letter of credit term has been included. Payment "according to the contract" contemplates immediate payment, payment at the end of an agreed credit term, payment by a time acceptance or the like. Under this Act, "contract" means the total obligation in law which results from the parties' agreement including the effect of this Article. In this context, therefore, there must be considered the effect in law of such provisions as those on means and manner of payment and on failure of agreed means and manner of payment.

3. Subsection (2) deals with the effect of a conditional delivery by the seller and in such a situation makes the buyer's "right as against the seller" conditional upon payment. These words are used as words of limitation to conform with the policy set forth in the bona fide purchase sections of this Article. Should the seller after making such a conditional delivery fail to follow up his rights, the condition is waived. This subsection (2) codifies the cash seller's right of reclamation which is in the nature of a lien. There is no specific time limit for a cash seller to exercise the right of reclamation. However, the right will be defeated by delay causing prejudice to the buyer, waiver, estoppel, or ratification of the buyer's right to retain possession. Common law rules and precedents governing such principles are applicable (Section 1-103). If third parties are involved, Section 2-403(1) protects good faith purchasers. See PEB Commentary No. 1, dated March 10, 1990 **Appendix V, infra**.

Cross References:

Point 1: Sections 4-2-310, 4-2-503, 4-2-511, 4-2-601 and 4-2-711 to 4-2-713.

Point 2: Sections 4-1-201, 4-2-511 and 4-2-614.

Point 3: Sections 4-2-401, 4-2-403, and 4-2-702(1)(b).

Definitional Cross References:

"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Delivery". Section 4-1-201.
"Document of title". Section 4-1-201.
"Goods". Section 4-2-105.
"Rights". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

The operator of a livestock ring is a "seller" within the meaning of the UCC. Ranchers & Farmers Livestock Auction Co. v. Honey, 38 Colo. App. 69, 552 P.2d 313 (1976).

Right to reclaim not right to secure payment. The right to reclaim created by subsection (2) of this section is a right to undo the transaction, not a right to "secure" payment of the price as required by the definition of "security interest" under § 4-1-201 (37). Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Right to reclaim was not intended to be security interest. The right to reclaim goods sold in a cash sale transaction, as set forth in the UCC, is not and was not intended to be a security interest. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

The right to reclaim is not a species of interest in the goods which is the result of a transaction "intended to create a security interest" and is not created by contract as contemplated within the meaning of § 4-9-102. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Creation of security interest might allow more than mere recovery of goods. Section 4-2-702(3) states that successful reclamation "excludes all other remedies", and the creation of a security interest out of the right to reclaim might allow recovery which would be greater than the mere recovery of goods originally transferred. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Right not interest listed as having priority over unperfected security interest. The right to reclaim goods conveyed as part of a cash sale transaction is not one of the interests which is listed as having priority over an unperfected security interest. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Normally, purchaser may retain or dispose of goods once purchase price tendered. Normally, a seller's demand for payment upon delivery in a cash sale transaction would allow a purchaser of goods to retain or dispose of the goods as he saw fit once the agreed-to purchase price was tendered. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Where payment is due and is demanded on delivery of documents of title to the buyer of goods, his right as against the seller to retain or dispose of them is conditioned upon his making the payment due. Ranchers & Farmers Livestock Auction Co. v. Honey, 38 Colo. App. 69, 552 P.2d 313, cert. dismissed, 191 Colo. 503, 553 P.2d 799 (1976).

When seller presented buyer's check, which was dishonored, buyer no longer had the right to retain or dispose of the goods, and seller had the right to reclaim. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 32 Colo. App. 235, 511 P.2d 912 (1973), aff'd, 184 Colo. 166, 519 P.2d 354 (1974).

Under this section a seller may reclaim goods which he has sold to the buyer when the latter's check has been dishonored. Ranchers & Farmers Livestock Auction Co. v. Honey, 38 Colo. App. 69, 552 P.2d 313, cert. dismissed, 191 Colo. 503, 553 P.2d 799 (1976).

Payment by check is only conditional and is defeated by dishonor of the check on due presentment. Ranchers & Farmers Livestock Auction Co. v. Honey, 38 Colo. App. 69, 552 P.2d 313, cert. dismissed, 191 Colo. 503, 553 P.2d 799 (1976).

4-2-508. Cure by seller of improper tender or delivery - replacement. (1) Where any tender or delivery by the seller is rejected because nonconforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a nonconforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance, the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

Source: L. 65: p. 1324, § 1. **C.R.S. 1963:** § 155-2-508.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Subsection (1) permits a seller who has made a non-conforming tender in any case to make a conforming delivery within the contract time upon seasonable notification to the buyer. It applies even where the seller has taken back the non-conforming goods and refunded the purchase price. He may still make a good tender within the contract period. The closer, however,

it is to the contract date, the greater is the necessity for extreme promptness on the seller's part in notifying of his intention to cure, if such notification is to be "seasonable" under this subsection.

The rule of this subsection, moreover, is qualified by its underlying reasons. Thus if, after contracting for June delivery, a buyer later makes known to the seller his need for shipment early in the month and the seller ships accordingly, the "contract time" has been cut down by the supervening modification and the time for cure of tender must be referred to this modified time term.

2. Subsection (2) seeks to avoid injustice to the seller by reason of a surprise rejection by the buyer. However, the seller is not protected unless he had "reasonable grounds to believe" that the tender would be acceptable. Such reasonable grounds can lie in prior course of dealing, course of performance or usage of trade as well as in the particular circumstances surrounding the making of the contract. The seller is charged with commercial knowledge of any factors in a particular sales situation which require him to comply strictly with his obligations under the contract as, for example, strict conformity of documents in an overseas shipment or the sale of precision parts or chemicals for use in manufacture. Further, if the buyer gives notice either implicitly, as by a prior course of dealing involving rigorous inspections, or expressly, as by the deliberate inclusion of a "no replacement" clause in the contract, the seller is to be held to rigid compliance. If the clause appears in a "form" contract evidence that it is out of line with trade usage or the prior course of dealing and was not called to the seller's attention may be sufficient to show that the seller had reasonable grounds to believe that the tender would be acceptable.

3. The words "a further reasonable time to substitute a conforming tender" are intended as words of limitation to protect the buyer. What is a "reasonable time" depends upon the attending circumstances. Compare Section 2-511 on the comparable case of a seller's surprise demand for legal tender.

4. Existing trade usages permitting variations without rejection but with price allowance enter into the agreement itself as contractual limitations of remedy and are not covered by this section.

Cross References:

Point 2: Section 4-2-302.
Point 3: Section 4-2-511.
Point 4: Sections 4-1-205 and 4-2-721.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Conforming". Section 4-2-106.
"Contract". Section 4-1-201.
"Money". Section 4-1-201.
"Notifies". Section 4-1-201.
"Reasonable time". Section 4-1-204.
"Seasonably". Section 4-1-204.
"Seller". Section 4-2-103.

4-2-509. Risk of loss in the absence of breach. (1) Where the contract requires or authorizes the seller to ship the goods by carrier:

(a) If it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (section 4-2-505); but

(b) If it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery.

(2) Where the goods are held by a bailee to be delivered without being moved the risk of loss passes to the buyer:

(a) On the buyer's receipt of possession or control of a negotiable document of title covering the goods; or

(b) On acknowledgment by the bailee of the buyer's right to possession of the goods; or

(c) After the buyer's receipt of possession or control of a nonnegotiable document of title or other direction to deliver in a record, as provided in subsection (4) (b) of section 4-2-503.

(3) In any case not within subsection (1) or (2) of this section, the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise, the risk passes to the buyer on tender of delivery.

(4) The provisions of this section are subject to contrary agreement of the parties and to the provisions of this article on sale on approval (section 4-2-327) and on effect of breach on risk of loss (section 4-2-510).

Source: L. 65: p. 1325, § 1. **C.R.S. 1963:** § 155-2-509. **L. 2006:** (2)(a) and (2)(c) amended, p. 492, § 13, effective September 1.

OFFICIAL COMMENT

1. The underlying theory of these sections on risk of loss is the adoption of the contractual approach rather than an arbitrary shifting of the risk with the "property" in the goods. The scope of the present section, therefore, is limited strictly to those cases where there has been no breach by the seller. Where for any reason his delivery or tender fails to conform to the contract, the present section does not apply and the situation is governed by the provisions on effect of breach on risk of loss.

2. The provisions of subsection (1) apply where the contract "requires or authorizes" shipment of the goods. This language is intended to be construed parallel to comparable language in the section on shipment by seller. In order that the goods be "duly delivered to the carrier" under paragraph (a) a contract must be entered into with the carrier which will satisfy the requirements of the section on shipment by the seller and the delivery must be made under circumstances which will enable the seller to take any further steps necessary to a due tender. The underlying reason of this subsection does not require that the shipment be made after contracting, but where, for example, the seller buys the goods afloat and later diverts the shipment to the buyer, he must identify the goods to the contract before the risk of loss can pass. To transfer the risk it is enough that a proper shipment and a proper identification come to apply to the same goods although, aside from special agreement, the risk will not pass retroactively to the time of shipment in such a case.

3. Whether the contract involves delivery at the seller's place of business or at the situs of the goods, a merchant seller cannot transfer risk of loss and it remains upon him until actual receipt by the buyer, even though full payment has been made and the buyer has been notified that the goods are at his disposal. Protection is afforded him, in the event of breach by the buyer, under the next section.

The underlying theory of this rule is that a merchant who is to make physical delivery at his own place continues meanwhile to control the goods and can be expected to insure his interest in them. The buyer, on the other hand, has no control of the goods and it is extremely unlikely that he will carry insurance on goods not yet in his possession.

4. Where the agreement provides for delivery of the goods as between the buyer and seller without removal from the physical possession of a bailee, the provisions on manner of tender of delivery apply on the point of transfer of risk. Due delivery of a negotiable document of title covering the goods or acknowledgment by the bailee that he holds for the buyer completes the "delivery" and passes the risk.

5. The provisions of this section are made subject by subsection (4) to the "contrary agreement" of the parties. This language is intended as the equivalent of the phrase "unless otherwise agreed" used more frequently throughout this Act. "Contrary" is in no way used as a word of limitation and the buyer and seller are left free to readjust their rights and risks as declared by this section in any manner agreeable to them. Contrary agreement can also be found in the circumstances of the case, a trade usage or practice, or a course of dealing or performance.

Cross References:

Point 1: Section 4-2-510(1).
Point 2: Sections 4-2-503 and 4-2-504.
Point 3: Sections 4-2-104, 4-2-503 and 4-2-510.
Point 4: Section 4-2-503(4).
Point 5: Section 4-1-201.

Definitional Cross References:

"Agreement". Section 4-1-201.
"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Delivery". Section 4-1-201.
"Document of title". Section 4-1-201.
"Goods". Section 4-2-105.
"Merchant". Section 4-2-104.
"Party". Section 4-1-201.
"Receipt" of goods. Section 4-2-103.
"Sale on approval". Section 4-2-326.
"Seller". Section 4-2-103.

4-2-510. Effect of breach on risk of loss. (1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection, the risk of their loss remains on the seller until cure or acceptance.

(2) Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.

(3) Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of their loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time.

Source: L. 65: p. 1325, § 1. **C.R.S. 1963:** § 155-2-510.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes: To make clear that:

1. Under subsection (1) the seller by his individual action cannot shift the risk of loss to the buyer unless his action conforms with all the conditions resting on him under the contract.

2. The "cure" of defective tenders contemplated by subsection (1) applies only to those situations in which the seller makes changes in goods already tendered, such as repair, partial substitution, sorting out from an improper mixture and the like since "cure" by repossession and new tender has no effect on the risk of loss of the goods originally tendered. The seller's privilege of cure does not shift the risk, however, until the cure is completed.

Where defective documents are involved a cure of the defect by the seller or a waiver of the defects by the buyer will operate to shift the risk under this section. However, if the goods have been destroyed prior to the cure or the buyer is unaware of their destruction at the time he waives the defect in the documents, the risk of the loss must still be borne by the seller, for the risk shifts only at the time of cure, waiver of documentary defects or acceptance of the goods.

3. In cases where there has been a breach of the contract, if the one in control of the goods is the aggrieved party, whatever loss or damage may prove to be uncovered by his insurance falls upon the contract breaker under subsections (2) and (3) rather than upon him. The word "effective" as applied to insurance coverage in those subsections is used to meet the case of supervening insolvency of the insurer. The "deficiency" referred to in the text means such deficiency in the insurance coverage as exists without subrogation. This section merely distributes the risk of loss as stated and is not intended to be disturbed by any subrogation of an insurer.

Cross Reference:
Section 4-2-509.

Definitional Cross References:
"Buyer". Section 4-2-103.
"Conform". Section 4-2-106.
"Contract for sale". Section 4-2-106.
"Goods". Section 4-2-105.
"Seller". Section 4-2-103.

4-2-511. Tender of payment by buyer; payment by check; certification of payment in livestock transactions. (1) Unless otherwise agreed, tender of payment is a condition to the seller's duty to tender and complete any delivery.

(2) Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business, unless the seller demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

(3) Subject to the provisions of this chapter on the effect of an instrument on an obligation (section 4-3-310), payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment.

(4) (a) When livestock have been delivered under a transaction of purchase and on the accompanying brand inspection certificate or memorandum of brand inspection certificate the seller has conspicuously noted that payment of the consideration for the transaction has not been received, the seller shall send a certificate of payment stating that payment has been made either within ten days after receipt of a check drawn and payable within the United States or, in any other case, within three business days after payment has been made.

(b) Unless otherwise agreed, when payment has been made, the buyer shall have a specifically enforceable right to the unqualified certification of payment from the seller and, where the seller has failed to provide the certification of payment in accordance with the provisions of this subsection (4), the seller will be deemed to have failed to make delivery of the livestock.

Source: L. 65: p. 1326, § 1. **C.R.S. 1963:** § 155-2-511. **L. 75:** (4) added, p. 233, § 4, effective June 20. **L. 94:** (3) amended, p. 905, § 5, effective January 1, 1995.

Editor's note - Colorado legislative change: Colorado added subsection (4). There is no counterpart to subsection (4) in the uniform act.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 42, Uniform Sales Act.
Changes: Rewritten by this section and Section 2-507.
Purposes of Changes:

1. The requirement of payment against delivery in subsection (1) is applicable to noncommercial sales generally and to ordinary sales at retail although it has no application to the great body of commercial contracts which carry credit terms. Subsection (1) applies also to documentary contracts in general and to contracts which look to shipment by the seller but contain no term on time and manner of payment, in which situations the payment may, in proper case, be demanded against delivery of appropriate documents.

In the case of specific transactions such as C.O.D. sales or agreements providing for payment against documents, the provisions of this subsection must be considered in conjunction with the special sections of the Article dealing with such terms. The provision that tender of payment is a condition to the seller's duty to tender and complete "any delivery" integrates this section with the language and policy of the section on delivery in several lots which call for separate payment. Finally, attention should be directed to the provision on right to adequate assurance of performance which recognizes, even before the time for tender, an obligation on the buyer not to impair the seller's expectation of receiving payment in due course.

2. Unless there is agreement otherwise the concurrence of the conditions as to tender of payment and tender of delivery requires their performance at a single place or time. This Article determines that place and time by determining in various other sections the place and time for tender of delivery under various circumstances and in particular types of transactions. The sections dealing with time and place of delivery together with the section on right to inspection of goods answer the subsidiary question as to when payment may be demanded before inspection by the buyer.

3. The essence of the principle involved in subsection (2) is avoidance of commercial surprise at the time of performance. The section on substituted performance covers the peculiar case in which legal tender is not available to the commercial community.

4. Subsection (3) is concerned with the rights and obligations as between the parties to a sales transaction when payment is made by check. This Article recognizes that the taking of a seemingly solvent party's check is commercially normal and proper and, if due diligence is exercised in collection, is not to be penalized in any way. The conditional character of the payment under this section refers only to the effect of the transaction "as between the parties" thereto and does not purport to cut into the law of "absolute" and "conditional" payment as applied to such other problems as the discharge of sureties or the responsibilities of a drawee bank which is at the same time an agent for collection.

The phrase "by check" includes not only the buyer's own but any check which does not effect a discharge under Article 3 (Section 3-802). Similarly the reason of this subsection should apply and the same result should be reached where the buyer "pays" by sight draft on a commercial firm which is financing him.

5. Under subsection (3) payment by check is defeated if it is not honored upon due presentment. This corresponds to the provisions of article on Commercial Paper. (Section 3-802). But if the seller procures certification of the check instead of cashing it, the buyer is discharged. (Section 3-411).

6. Where the instrument offered by the buyer is not a payment but a credit instrument such as a note or a check post-dated by even one day, the seller's acceptance of the instrument insofar as third parties are concerned, amounts to a delivery on credit and his remedies are set forth in the section on buyer's insolvency. As between the buyer and the seller, however, the matter turns on the present subsection and the section on conditional delivery and subsequent dishonor of the instrument gives the seller rights on it as well as for breach of the contract for sale.

Cross References:

Point 1: Sections 4-2-307, 4-2-310, 4-2-320, 4-2-325, 4-2-503, 4-2-513 and 4-2-609.

Point 2: Sections 4-2-307, 4-2-310, 4-2-319, 4-2-322, 4-2-503, 4-2-504 and 4-2-513.

Point 3: Section 4-2-614.

Point 5: Article 3, esp. Sections 3-802 and 4-3-411.

Point 6: Sections 4-2-507, 4-2-702, and Article 3.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Check". Section 4-3-104.
"Dishonor". Section 4-3-502.
"Party". Section 4-1-201.
"Reasonable time". Section 4-1-204.
"Seller". Section 4-2-103.

ANNOTATION

Purchaser receives voidable title when he pays by check. Under the UCC, the purchaser of goods in a cash sale transaction normally acquires full title to the goods which he purchases after payment is made, but the purchaser is limited to receiving a voidable title when the purchase price is conveyed in the form of a check. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Payment by check is conditional upon the check being honored at presentment. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 32 Colo. App. 235, 511 P.2d 912 (1973), aff'd, 184 Colo. 166, 519 P.2d 354 (1974).

Payment by check is only conditional and is defeated by dishonor of the check on due presentment. Ranchers & Farmers Livestock Auction Co. v. Honey, 38 Colo. App. 69, 552 P.2d 313, cert. dismissed, 191 Colo. 503, 553 P.2d 799 (1976).

Payment by check is conditional only and does not discharge the liability for which payment is given, unless there is an express or implied agreement that the check be accepted as absolute payment. Bolz v. Security Mut. Life Ins. Co., 721 P.2d 1216 (Colo. App. 1986).

Such title dependent upon seller's power to transfer an interest in goods. The voidable title which a purchaser receives when payment is made by check is dependent upon the seller's power to transfer an interest in the goods conveyed. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Purchaser took voidable title on proper transfer of title certificates. Where before the seller presented the purchaser's check for collection, the certificates of title to automobiles were delivered to a bank as security for the bank's loan to the purchaser, in accordance with a security agreement between the purchaser and bank, it could be implied that the bank took possession of the certificates of title as the purchaser's agent. At the moment the seller delivered the certificates of title to the purchaser, through the bank as its agent, the requirements of § 42-6-108 were satisfied. Moreover, once the certificates of title were properly transferred, the purchaser was clothed with voidable title and could legally encumber the automobiles. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

4-2-512. Payment by buyer before inspection. (1) Where the contract requires payment before inspection, nonconformity of the goods does not excuse the buyer from so making payment unless:

(a) The nonconformity appears without inspection; or

(b) Despite tender of the required documents, the circumstances would justify injunction against honor under this title (section 4-5-109 (b)).

(2) Payment pursuant to subsection (1) of this section does not constitute an acceptance of goods or impair the buyer's right to inspect or impair any of his remedies.

Source: L. 65: p. 1326, § 1. **C.R.S. 1963:** § 155-2-512. **L. 96:** (1)(b) amended, p. 234, § 5, effective July 1.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None, but see Sections 47 and 49, Uniform Sales Act.

Purposes:

1. Subsection (1) of the present section recognizes that the essence of a contract providing for payment before inspection is the intention of the parties to shift to the buyer the risks which would usually rest upon the seller. The basic nature of the transaction is thus preserved and the buyer is in most cases required to pay first and litigate as to any defects later.

2. "Inspection" under this section is an inspection in a manner reasonable for detecting defects in goods whose surface appearance is satisfactory.

3. Clause (a) of this subsection states an exception to the general rule based on common sense and normal commercial practice. The apparent non-conformity referred to is one which is evident in the mere process of taking delivery.

4. Clause (b) is concerned with contracts for payment against documents and incorporates the general clarification and modification of the case law contained in the section on excuse of a financing agency. Section 5-114.

5. Subsection (2) makes explicit the general policy of the Uniform Sales Act that the payment required before inspection in no way impairs the buyer's remedies or rights in the event of a default by the seller. The remedies preserved to the buyer are all of his remedies, which include as a matter of reason the remedy for total non-delivery after payment in advance.

The provision on performance or acceptance under reservation of rights does not apply to the situations contemplated here in which payment

is made in due course under the contract and the buyer need not pay "under protest" or the like in order to preserve his rights as to defects discovered upon inspection.

6. This section applies to cases in which the contract requires payment before inspection either by the express agreement of the parties or by reason of the effect in law of that contract. The present section must therefore be considered in conjunction with the provision on right to inspection of goods which sets forth the instances in which the buyer is not entitled to inspection before payment.

Cross References:
Point 4: Article 5.
Point 5: Section 4-1-207.
Point 6: Section 4-2-513(3).

Definitional Cross References:
"Buyer". Section 4-2-103.
"Conform". Section 4-2-106.
"Contract". Section 4-1-201.
"Financing agency". Section 4-2-104.
"Goods". Section 4-2-105.
"Remedy". Section 4-1-201.
"Rights". Section 4-1-201.

4-2-513. Buyer's right to inspection of goods. (1) Unless otherwise agreed and subject to subsection (3) of this section, where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

(2) Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.

(3) Unless otherwise agreed and subject to the provisions of this article on C.I.F. contracts (subsection (3) of section 4-2-321), the buyer is not entitled to inspect the goods before payment of the price when the contract provides:

(a) For delivery "C.O.D." or on other like terms; or

(b) For payment against documents of title, except where such payment is due only after the goods are to become available for inspection.

(4) A place or method of inspection fixed by the parties is presumed to be exclusive, but unless otherwise expressly agreed, it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section, unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract.

Source: L. 65: p. 1326, § 1. **C.R.S. 1963:** § 155-2-513.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 47(2), (3), Uniform Sales Act.

Changes: Rewritten, Subsections (2) and (3) being new.

Purposes of Changes and New Matter: To correspond in substance with the prior uniform statutory provision and to incorporate in addition some of the results of the better case law so that:

1. The buyer is entitled to inspect goods as provided in subsection (1) unless it has been otherwise agreed by the parties. The phrase "unless otherwise agreed" is intended principally to cover such situations as those outlined in subsections (3) and (4) and those in which the agreement of the parties negates inspection before tender of delivery. However, no agreement by the parties can displace the entire right of inspection except where the contract is simply for the sale of "this thing." Even in a sale of boxed goods "as is" inspection is a right of the buyer, since if the boxes prove to contain some other merchandise altogether the price can be recovered back; nor do the limitations of the provision on effect of acceptance apply in such a case.

2. The buyer's right of inspection is available to him upon tender, delivery or appropriation of the goods with notice to him. Since inspection is available to him on tender, where payment is due against delivery he may, unless otherwise agreed, make his inspection before payment of the price. It is also available to him after receipt of the goods and so may be postponed after receipt for a reasonable time. Failure to inspect before payment does not impair the right to inspect after receipt of the goods unless the case falls within subsection (4) on agreed and exclusive inspection provisions. The right to inspect goods which have been appropriated with notice to the buyer holds whether or not the sale was by sample.

3. The buyer may exercise his right of inspection at any reasonable time or place and in any reasonable manner. It is not necessary that he select the most appropriate time, place or manner to inspect or that his selection be the customary one in the trade or locality. Any

reasonable time, place or manner is available to him and the reasonableness will be determined by trade usages, past practices between the parties and the other circumstances of the case.

The last sentence of subsection (1) makes it clear that the place of arrival of shipped goods is a reasonable place for their inspection.

4. Expenses of an inspection made to satisfy the buyer of the seller's performance must be assumed by the buyer in the first instance. Since the rule provides merely for an allocation of expense there is no policy to prevent the parties from providing otherwise in the agreement. Where the buyer would normally bear the expenses of the inspection but the goods are rightly rejected because of what the inspection reveals, demonstrable and reasonable costs of the inspection are part of his incidental damage caused by the seller's breach.

5. In the case of payment against documents, subsection (3) requires payment before inspection, since shipping documents against which payment is to be made will commonly arrive and be tendered while the goods are still in transit. This Article recognizes no exception in any peculiar case in which the goods happen to arrive before the documents. However, where by the agreement payment is to await the arrival of the goods, inspection before payment becomes proper since the goods are then "available for inspection."

Where by the agreement the documents are to be held until arrival the buyer is entitled to inspect before payment since the goods are then "available for inspection". Proof of usage is not necessary to establish this right, but if inspection before payment is disputed the contrary must be established by usage or by an explicit contract term to that effect.

For the same reason, that the goods are available for inspection, a term calling for payment against storage documents or a delivery order does not normally bar the buyer's right to inspection before payment under subsection (3)(b). This result is reinforced by the buyer's right under subsection (1) to inspect goods which have been appropriated with notice to him.

6. Under subsection (4) an agreed place or method of inspection is generally held to be intended as exclusive. However, where compliance with such an agreed inspection term becomes impossible, the question is basically one of intention. If the parties clearly intend that the method of inspection named is to be a necessary condition without which the entire deal is to fail, the contract is at an end if that method becomes impossible. On the other hand, if the parties merely seek to indicate a convenient and reliable method but do not intend to give up the deal in the event of its failure, any reasonable method of inspection may be substituted under this Article.

Since the purpose of an agreed place of inspection is only to make sure at that point whether or not the goods will be thrown back, the "exclusive" feature of the named place is satisfied under this Article if the buyer's failure to inspect there is held to be an acceptance with the knowledge of such defects as inspection would have revealed within the section on waiver of buyer's objections by failure to particularize. Revocation of the acceptance is limited to the situations stated in the section pertaining to that subject. The reasonable time within which to give notice of defects within the section on notice of breach begins to run from the point of the "acceptance."

7. Clauses on time of inspection are commonly clauses which limit the time in which the buyer must inspect and give notice of defects. Such clauses are therefore governed by the section of this Article which requires that such a time limitation must be reasonable.

8. Inspection under this Article is not to be regarded as a "condition precedent to the passing of title" so that risk until inspection remains on the seller. Under subsection (4) such an approach cannot be sustained. Issues between the buyer and seller are settled in this Article almost wholly by special provisions and not by the technical determination of the locus of the title. Thus "inspection as a condition to the passing of title" becomes a concept almost without meaning. However, in peculiar circumstances inspection may still have some of the consequences hitherto sought and obtained under that concept.

9. "Inspection" under this section has to do with the buyer's check-up on whether the seller's performance is in accordance with a contract previously made and is not to be confused with the "examination" of the goods or of a sample or model of them at the time of contracting which may affect the warranties involved in the contract.

Cross References:

Generally: Sections 4-2-310(b), 4-2-321(3) and 4-2-606(1)(b).

Point 1: Section 4-2-607.

Point 2: Sections 4-2-501 and 4-2-502.

Point 4: Section 4-2-715.

Point 5: Section 4-2-321(3).

Point 6: Sections 4-2-606 to 4-2-608.

Point 7: Section 4-1-204.

Point 8: Comment to Section 4-2-401.

Point 9: Section 4-2-316(3)(b).

Definitional Cross References:

"Buyer". Section 4-2-103.

"Conform". Section 4-2-106.

"Contract". Section 4-1-201.

"Contract for sale". Section 4-2-106.

"Document of title". Section 4-1-201.

"Goods". Section 4-2-105.

"Party". Section 4-1-201.

"Presumed". Section 4-1-201.

"Reasonable time". Section 4-1-204.
"Rights". Section 4-1-201.
"Seller". Section 4-2-103.
"Send". Section 4-1-201.
"Term". Section 4-1-201.

ANNOTATION

Applied in Hummel v. Skyline Dodge, Inc., 41 Colo. App. 572, 589 P.2d 73 (1978).

4-2-514. When documents deliverable on acceptance - when on payment. Unless otherwise agreed, documents against which a draft is drawn are to be delivered to the drawee on acceptance of the draft if it is payable more than three days after presentment; otherwise, only on payment.

Source: L. 65: p. 1327, § 1. **C.R.S. 1963:** § 155-2-514.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 41, Uniform Bills of Lading Act.
Changes: Rewritten.
Purposes of Changes: To make the provision one of general application so that:

1. It covers any document against which a draft may be drawn, whatever may be the form of the document, and applies to interpret the action of a seller or consignor insofar as it may affect the rights and duties of any buyer, consignee or financing agency concerned with the paper. Supplementary or corresponding provisions are found in Sections 4-503 and 5-112.

2. An "arrival" draft is a sight draft within the purpose of this section.

Cross References:
Point 1: See Sections 4-2-502, 4-2-505(2), 4-2-507(2), 4-2-512, 4-2-513, 4-2-607 concerning protection of rights of buyer and seller, and 4-503 and 5-112 on delivery of documents.
Definitional Cross References:
"Delivery". Section 4-1-201.
"Draft". Section 4-3-104.

4-2-515. Preserving evidence of goods in dispute. In furtherance of the adjustment of any claim or dispute:

(a) Either party, on reasonable notification to the other and for the purpose of ascertaining the facts and preserving evidence, has the right to inspect, test, and sample the goods, including such of them as may be in the possession or control of the other; and

(b) The parties may agree to a third party inspection or survey to determine the conformity or condition of the goods and may agree that the findings shall be binding upon them in any subsequent litigation or adjustment.

Source: L. 65: p. 1327, § 1. **C.R.S. 1963:** § 155-2-515.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes:

1. To meet certain serious problems which arise when there is a dispute as to the quality of the goods and thereby perhaps to aid the parties in reaching a settlement, and to further the use of devices which will promote certainty as to the condition of the goods, or at least aid in preserving evidence of their condition.

2. Under paragraph (a), to afford either party an opportunity for preserving evidence, whether or not agreement has been reached, and thereby to reduce uncertainty in any litigation and, in turn perhaps, to promote agreement.

Paragraph (a) does not conflict with the provisions on the seller's right to resell rejected goods or the buyer's similar right. Apparent conflict between these provisions which will be suggested in certain circumstances is to be resolved by requiring prompt action by the parties. Nor does paragraph (a) impair the effect of a term for payment before inspection. Short of such defects as amount to fraud or substantial failure of consideration, non-conformity is neither an excuse nor a defense to an action for non-acceptance of documents. Normally, there-

fore, until the buyer has made payment, inspected and rejected the goods, there is no occasion or use for the rights under paragraph (a).

3. Under paragraph (b), to provide for third party inspection upon the agreement of the parties, thereby opening the door to amicable adjustments based upon the findings of such third parties.

The use of the phrase "conformity or condition" makes it clear that the parties' agreement may range from a complete settlement of all aspects of the dispute by a third party to the use of a third party merely to determine and record the condition of the goods so that they can be resold or used to reduce the stake in controversy. "Conformity", at one end of the scale of possible issues, includes the whole question of interpretation of the agreement and its legal effect, the state of the goods in regard to quality and condition, whether any defects are due to factors which operate at the risk of the buyer, and the degree of non-conformity where that may be material. "Condition", at the other end of the scale, includes nothing but the degree of damage or deterioration which the goods show. Paragraph (b) is intended to reach any point in the gamut which the parties may agree upon.

The principle of the section on reservation of rights reinforces this paragraph in simplifying such adjustments as the parties wish to make in partial settlement while reserving their rights as to any further points. Paragraph (b) also suggests the use of arbitration, where desired, of any points left open, but nothing in this section is intended to repeal or amend any statute governing arbitration. Where any question arises as to the extent of the parties' agreement under the paragraph, the presumption should be that it was meant to extend only to the relation between the contract description and the goods as delivered, since that is what a craftsman in the trade would normally be expected to report upon. Finally, a written and authenticated report of inspection or tests by a third party, whether or not sampling has been practicable, is entitled to be admitted as evidence under this Act, for it is a third party document.

Cross References:

Point 2: Sections 4-2-513(3), 4-2-706 and 4-2-711(2) and Article 5.

Point 3: Sections 4-1-202 and 4-1-207.

Definitional Cross References:

"Conform". Section 4-2-106.

"Goods". Section 4-2-105.

"Notification". Section 4-1-201.

"Party". Section 4-1-201.

PART 6

BREACH, REPUDIATION, AND EXCUSE

4-2-601. Buyer's rights on improper delivery. Subject to the provisions of this article on breach in installment contracts (section 4-2-612) and unless otherwise agreed under the sections on contractual limitations of remedy (sections 4-2-718 and 4-2-719), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may:

(a) Reject the whole; or

(b) Accept the whole; or

(c) Accept any commercial unit or units and reject the rest.

Source: L. 65: p. 1327, § 1. **C.R.S. 1963:** § 155-2-601.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: No one general equivalent provision but numerous provisions, dealing with situations of non-conformity where buyer may accept or reject, including Sections 11, 44 and 69(1), Uniform Sales Act.

Changes: Partial acceptance in good faith is recognized and the buyer's remedies on the contract for breach of warranty and the like, where the buyer has returned the goods after transfer of title, are no longer barred.

Purposes of Changes: To make it clear that:

1. A buyer accepting a non-conforming tender is not penalized by the loss of any remedy otherwise open to him. This policy extends to cover and regulate the acceptance of a part of any lot improperly tendered in any case where the price can reasonably be apportioned. Partial acceptance is permitted whether the part of the goods accepted conforms or not. The only limitation on partial acceptance is that good faith and commercial reasonableness must be used to avoid undue impairment of the value of the remaining portion of the goods. This is the reason for the insistence on the "commercial unit" in paragraph (c). In this respect, the test is not only what unit has been the basis of contract, but whether the partial acceptance produces so materially adverse an effect on the remainder as to constitute bad faith.

2. Acceptance made with the knowledge of the other party is final. An original refusal to accept may be withdrawn by a later acceptance if the seller has indicated that he is holding the tender open. However, if the buyer attempts to accept, either in whole or in part, after his original rejection has caused the seller to arrange for other disposition of the goods, the buyer must answer for any ensuing damage since the next section provides that any exercise of ownership after rejection is wrongful as against the seller. Further, he is liable even though the seller may choose to treat his action as acceptance rather than conversion, since the damage flows from the misleading notice. Such arrangements for resale or other disposition of the goods by the seller must be viewed as within the normal contemplation of a buyer who has given notice of rejection. However, the buyer's attempts in good faith to dispose of defective goods where the seller has failed to give instructions within a reasonable time are not to be regarded as an acceptance.

Cross References:

Sections 4-2-602(2)(a), 4-2-612, 4-2-718 and 4-2-719.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Commercial unit". Section 4-2-105.
"Conform". Section 4-2-106.
"Contract". Section 4-1-201.
"Goods". Section 4-2-105.
"Installment contract". Section 4-2-612.
"Rights". Section 4-1-201.

ANNOTATION

Buyer bound to accept undamaged part of goods. Where a minor part of the goods consigned to the buyer are damaged, but the entire shipment is rejected, the buyer is bound to accept such of the goods as are undamaged. Denver-Chicago Trucking Co. v. Republic Drug Co., 134 Colo. 461, 306 P.2d 1076 (1957) (decided under repealed § 121-1-69(1), CRS 53, uniform sales act).

Applied in Eccher v. Small Bus. Admin., 643 F.2d 1388 (10th Cir. 1981); Western Conference Resorts, Inc. v. Pease, 668 P.2d 973 (Colo. App. 1983); Mari v. Wagner Equipment Co., Inc., 721 P.2d 1208 (Colo. App. 1986).

4-2-602. Manner and effect of rightful rejection. (1) Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.

(2) Subject to the provisions of the two following sections on rejected goods (sections 4-2-603 and 4-2-604):

(a) After rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller; and

(b) If the buyer has before rejection taken physical possession of goods in which he does not have a security interest under the provisions of this article (subsection (3) of section 4-2-711), he is under a duty after rejection to hold them with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them; but

(c) The buyer has no further obligations with regard to goods rightfully rejected.

(3) The seller's rights with respect to goods wrongfully rejected are governed by the provisions of this article on seller's remedies in general (section 4-2-703).

Source: L. 65: p. 1328, § 1. **C.R.S. 1963:** § 155-2-602.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 50, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

1. A tender or delivery of goods made pursuant to a contract of sale, even though wholly non-conforming, requires affirmative action by the buyer to avoid acceptance. Under subsection (1), therefore, the buyer is given a reasonable time to notify the seller of his rejection, but without such seasonable notification his rejection is ineffective. The sections of this Article dealing with inspection of goods must be read in connection with the buyer's reasonable time for action under this subsection. Contract provisions limiting the time for rejection fall within the rule of the section on "Time" and are effective if the time set gives the buyer a reasonable time for discovery of defects. What constitutes a due "notifying" of rejection by the buyer to the seller is defined in Section 1-201.

2. Subsection (2) lays down the normal duties of the buyer upon rejection, which flow from the relationship of the parties. Beyond his duty to hold the goods with reasonable care for the buyer's [seller's] disposition, this section

continues the policy of prior uniform legislation in generally relieving the buyer from any duties with respect to them, except when the circumstances impose the limited obligation of salvage upon him under the next section.

3. The present section applies only to rightful rejection by the buyer. If the seller has made a tender which in all respects conforms to the contract, the buyer has a positive duty to accept and his failure to do so constitutes a "wrongful rejection" which gives the seller immediate remedies for breach. Subsection (3) is included here to emphasize the sharp distinction between the rejection of an improper tender and the non-acceptance which is a breach by the buyer.

4. The provisions of this section are to be appropriately limited or modified when a negotiation is in process.

Cross References:

Point 1: Sections 4-1-201, 4-1-204(1) and (3), 4-2-512(2), 4-2-513(1) and 4-2-606(1)(b).

Point 2: Section 4-2-603(1).

Point 3: Section 4-2-703.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Commercial unit". Section 4-2-105.
"Goods". Section 4-2-105.
"Merchant". Section 4-2-104.
"Notifies". Section 4-1-201.
"Reasonable time". Section 4-1-204.
"Remedy". Section 4-1-201.
"Rights". Section 4-1-201.
"Seasonably". Section 4-1-204.
"Security interest". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Purpose of subsection (2)(a) is to insure that the seller may regain possession of the goods in order to resell the goods or utilize them in order to minimize his loss. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974); Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

What serves as effective notice of rejection depends on the nature, purpose, and circumstances of such notice. Western Conference Resorts, Inc. v. Pease, 668 P.2d 973 (Colo. App. 1983).

Notice of rejection is sufficient if it gives the seller an opportunity to correct the defect and prepare for negotiations and litigation, and if it protects the seller against claims asserted after it is too late to investigate. Western Conference Resorts, Inc. v. Pease, 668 P.2d 973 (Colo. App. 1983).

Retention of goods for an unreasonable amount of time is not justified. No more than six months can be justified as a reasonable period for inspection and testing, and retaining the goods after demand for payment and even after filing of suit is not a holding in good faith or good faith conduct. Surplus Electronics Corp. v. Gallin, 653 P.2d 752 (Colo. App. 1982).

A failure to reject is acceptance. Purchaser's failure seasonably to notify seller of the ultimate rejection of such of the goods as purchaser deemed unusable renders any claim of rejection ineffective and constitutes an acceptance. Surplus Electronics Corp. v. Gallin, 653 P.2d 752 (Colo. App. 1982).

After rejection of goods, any exercise of dominion and ownership rights is considered wrongful as against the seller. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974); Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

Buyer who asserts a right to revoke acceptance has the same duties as a buyer who asserts a right to reject goods prior to acceptance. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974).

4-2-603. Merchant buyer's duties as to rightfully rejected goods. (1) Subject to any security interest in the buyer (subsection (3) of section 4-2-711), when the seller has no agent or place of business at the market of rejection a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instructions to make reasonable efforts to sell them for the seller's account if they are perishable or threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) When the buyer sells goods under subsection (1) of this section, he is entitled to reimbursement from the seller or out of the proceeds for reasonable expenses of caring for and selling them, and if the expenses include no selling commission, then to such commission as is usual in the trade, or if there is none, to a reasonable sum not exceeding ten percent on the gross proceeds.

(3) In complying with this section, the buyer is held only to good faith, and good faith conduct hereunder is neither acceptance nor conversion nor the basis of an action for damages.

Source: L. 65: p. 1328, § 1. **C.R.S. 1963:** § 155-2-603.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes:

1. This section recognizes the duty imposed upon the merchant buyer by good faith and commercial practice to follow any reasonable instructions of the seller as to reshipping, storing, delivery to a third party, reselling or the like. Subsection (1) goes further and extends the duty to include the making of reasonable efforts to effect a salvage sale where the value of the goods is threatened and the seller's instructions do not arrive in time to prevent serious loss.

2. The limitations on the buyer's duty to resell under subsection (1) are to be liberally construed. The buyer's duty to resell under this section arises from commercial necessity and thus is present only when the seller has "no agent or place of business at the market of rejection". A financing agency which is acting in behalf of the seller in handling the documents rejected by the buyer is sufficiently the seller's agent to lift the burden of salvage resale from the buyer. (See provisions of Sections 4-503 and 5-112 on bank's duties with respect to rejected documents.) The buyer's duty to resell is extended only to goods in his "possession or control", but these are intended as words of wide, rather than narrow, import. In effect, the measure of the buyer's "control" is whether he can practicably effect control without undue commercial burden.

3. The explicit provisions for reimbursement and compensation to the buyer in subsection (2) are applicable and necessary only where he is not acting under instructions from the seller. As provided in subsection (1) the seller's instructions to be "reasonable" must on demand of the buyer include indemnity for expenses.

4. Since this section makes the resale of perishable goods an affirmative duty in contrast to a mere right to sell as under the case law, subsection (3) makes it clear that the buyer is liable only for the exercise of good faith in determining whether the value of the goods is sufficiently threatened to justify a quick resale or whether he has waited a sufficient length of time for instructions, or what a reasonable means and place of resale is.

5. A buyer who fails to make a salvage sale when his duty to do so under this section has arisen is subject to damages pursuant to the section on liberal administration of remedies.

Cross References:

Point 2: Sections 4-503 and 5-112.

Point 5: Section 4-1-106. Compare generally section 4-2-706.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Good faith". Section 4-1-201.
"Goods". Section 4-2-105.
"Merchant". Section 4-2-104.
"Security interest". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Retention of goods for an unreasonable amount of time is not justified. No more than six months can be justified as a reasonable period for inspection and testing, and retaining the goods after demand for payment and even after filing of suit is not a holding in good faith or good faith conduct. Surplus Electronics Corp. v. Gallin, 653 P.2d 752 (Colo. App. 1982).

Statute as basis for jurisdiction. See Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

4-2-604. Buyer's options as to salvage of rightfully rejected goods. Subject to the provisions of section 4-2-603 on perishables, if the seller gives no instructions within a reasonable time after notification of rejection the buyer may store the rejected goods for the seller's account or reship them to him or resell them for the seller's account with reimbursement as provided in said section. Such action is not acceptance or conversion.

Source: L. 65: p. 1329, § 1. **C.R.S. 1963:** § 155-2-604.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes:

The basic purpose of this section is twofold: on the one hand it aims at reducing the stake in dispute and on the other at avoiding the pinning of a technical "acceptance" on a buyer who has taken steps towards realization on or preservation of the goods in good faith. This section is essentially a salvage section and the buyer's right to act under it is conditioned upon (1)

non-conformity of the goods, (2) due notification of rejection to the seller under the section on manner of rejection, and (3) the absence of any instructions from the seller which the merchant-buyer has a duty to follow under the preceding section.

This section is designed to accord all reasonable leeway to a rightfully rejecting buyer acting in good faith. The listing of what the buyer may do in the absence of instructions from the seller is intended to be not exhaustive but merely illustrative. This is not a "merchant's" section and the options are pure options given to merchant and nonmerchant buyers alike. The merchant-buyer, however, may in some instances be under a duty rather than an option to resell under the provisions of the preceding section.

Cross References:

Sections 4-2-602(1), and 4-2-603(1) and 4-2-706.

Definitional Cross References:

"Buyer". Section 4-2-103.

"Notification". Section 4-1-201.

"Reasonable time". Section 4-1-204.

"Seller". Section 4-2-103.

ANNOTATION

Seller was entitled to offset of fair and reasonable use value. Where the evidence showed that plaintiffs used mobile home for a considerable length of time after they should have acted under this section, it follows that this use reduced the value of the home, and accordingly, defendants are entitled to an offset of a fair and reasonable use value of the mobile home for this period. Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

4-2-605. Waiver of buyer's objections by failure to particularize. (1) The buyer's failure to state in connection with rejection a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach:

(a) Where the seller could have cured it if stated seasonably; or

(b) Between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely.

(2) Payment against documents made without reservation of rights precludes recovery of the payment for defects apparent in the documents.

Source: L. 65: p. 1329, § 1. **C.R.S. 1963:** § 155-2-605. **L. 2006:** (2) amended, p. 493, § 14, effective September 1.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. The present section rests upon a policy of permitting the buyer to give a quick and informal notice of defects in a tender without penalizing him for omissions in his statement, while at the same time protecting a seller who is reasonably misled by the buyer's failure to state curable defects.

2. Where the defect in a tender is one which could have been cured by the seller, a buyer who merely rejects the delivery without stating his objections to it is probably acting in commercial bad faith and seeking to get out of a deal which has become unprofitable. Subsection (1)(a), following the general policy of this Article which looks to preserving the deal wherever possible, therefore insists that the seller's right to correct his tender in such circumstances be protected.

3. When the time for cure is past, subsection (1)(b) makes it plain that a seller is entitled upon request to a final statement of objections upon which he can rely. What is needed is that he make clear to the buyer exactly what is being sought. A formal demand under paragraph (b) will be sufficient in the case of a merchant-buyer.

4. Subsection (2) applies to the particular case of documents the same principle which the section on effects of acceptance applies to the case of goods. The matter is dealt with in this section in terms of "waiver" of objections rather than of right to revoke acceptance, partly to avoid any confusion with the problems of acceptance of goods and partly because defects in documents which are not taken as grounds for rejection are generally minor ones. The only defects concerned in the present subsection are defects in the documents which are apparent on their face. Where payment is required against the documents they must be inspected before payment, and the payment then constitutes acceptance of the documents. Under the section dealing with this problem, such acceptance of the documents does not constitute an acceptance of the goods or impair any options or remedies

of the buyer for their improper delivery. Where the documents are delivered without requiring such contemporary action as payment from the buyer, the reason of the next section on what constitutes acceptance of goods, applies. Their acceptance by non-objection is therefore postponed until after a reasonable time for their inspection. In either situation, however, the buyer "waives" only what is apparent on the face of the documents.

Cross References:
Point 2: Section 4-2-508.
Point 4: Sections 4-2-512(2), 4-2-606(1)(b), 4-2-607(2).
Definitional Cross References:
"Between merchants". Section 4-2-104.
"Buyer". Section 4-2-103.
"Seasonably". Section 4-1-204.
"Seller". Section 4-2-103.
"Writing" and "written". Section 4-1-201.

4-2-606. What constitutes acceptance of goods. (1) Acceptance of goods occurs when the buyer:

(a) After a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their nonconformity; or

(b) Fails to make an effective rejection (subsection (1) of section 4-2-602), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or

(c) Does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller, it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

Source: L. 65: p. 1329, § 1. **C.R.S. 1963:** § 155-2-606.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 48, Uniform Sales Act.
Changes: Rewritten, the qualification in paragraph (c) and subsection (2) being new; otherwise the general policy of the prior legislation is continued.
Purposes of Changes and New Matter: To make it clear that:

1. Under this Article "acceptance" as applied to goods means that the buyer, pursuant to the contract, takes particular goods which have been appropriated to the contract as his own, whether or not he is obligated to do so, and whether he does so by words, action, or silence when it is time to speak. If the goods conform to the contract, acceptance amounts only to the performance by the buyer of one part of his legal obligation.

2. Under this Article acceptance of goods is always acceptance of identified goods which have been appropriated to the contract or are appropriated by the contract. There is no provision for "acceptance of title" apart from acceptance in general, since acceptance of title is not material under this Article to the detailed rights and duties of the parties. (See Section 2-401). The refinements of the older law between acceptance of goods and of title become unnecessary in view of the provisions of the sections on effect and revocation of acceptance, on effects of identification and on risk of loss, and those sections which free the seller's and buyer's remedies from the complications and confusions caused by the question of whether title has or has not passed to the buyer before breach.

3. Under paragraph (a), payment made after tender is always one circumstance tending to signify acceptance of the goods but in itself it can never be more than one circumstance and is not conclusive. Also, a conditional communication of acceptance always remains subject to its expressed conditions.

4. Under paragraph (c), any action taken by the buyer, which is inconsistent with his claim that he has rejected the goods, constitutes an acceptance. However, the provisions of paragraph (c) are subject to the sections dealing with rejection by the buyer which permit the buyer to take certain actions with respect to the goods pursuant to his options and duties imposed by those sections, without effecting an acceptance of the goods. The second clause of paragraph (c) modifies some of the prior case law and makes it clear that "acceptance" in law based on the wrongful act of the acceptor is acceptance only as against the wrongdoer and then only at the option of the party wronged.

In the same manner in which a buyer can bind himself, despite his insistence that he is rejecting or has rejected the goods, by an act inconsistent with the seller's ownership under paragraph (c), he can obligate himself by a communication of acceptance despite a prior rejection under paragraph (a). However, the sections on buyer's rights on improper delivery and on the effect of rightful rejection, make it clear that after he once rejects a tender, paragraph (a) does not operate in favor of the buyer unless the seller has re-tendered the goods or has taken affirmative action indicating that he is holding the tender open. See also Comment 2 to Section 2-601.

5. Subsection (2) supplements the policy of the section on buyer's rights on improper delivery, recognizing the validity of a partial acceptance but insisting that the buyer exercise this right only as to whole commercial units.

Cross References:

Point 2: Sections 4-2-401, 4-2-509, 4-2-510, 4-2-607, 4-2-608 and Part 7.

Point 4: Sections 4-2-601 through 4-2-604.

Point 5: Section 4-2-601.

Definitional Cross References:

"Buyer". Section 4-2-103.

"Commercial unit". Section 4-2-105.

"Goods". Section 4-2-105.

"Seller". Section 4-2-103.

ANNOTATION

Acceptance presumed after five days. Under this section where goods ordered were delivered to the buyer who took physical possession and control of them, stored them, and retained them for five days, such buyer was presumed to have accepted them. Vanadium Corp. of Am. v. Wesco Stores Co., 135 Colo. 77, 308 P.2d 1011 (1957) (decided under repealed § 121-1-48, CRS 53, uniform sales act).

Failure to reject constitutes acceptance. Purchaser's failure seasonably to notify seller of the ultimate rejection of such of the goods as purchaser deemed unusable renders any claim of rejection ineffective, and constitutes an acceptance. Surplus Electronics Corp. v. Gallin, 653 P.2d 752 (Colo. App. 1982).

Applied in Hummel v. Skyline Dodge, Inc., 41 Colo. App. 572, 589 P.2d 73 (1978); Eccher v. Small Bus. Admin., 643 F.2d 1388 (10th Cir. 1981); Western Conference Resorts, Inc. v. Pease, 668 P.2d 973 (Colo. App. 1983).

4-2-607. Effect of acceptance - notice of breach - burden of establishing breach after acceptance - notice of claim or litigation to person answerable over. (1) The buyer must pay at the contract rate for any goods accepted.

(2) Acceptance of goods by the buyer precludes rejection of the goods accepted and, if made with knowledge of a nonconformity, cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured; but acceptance does not of itself impair any other remedy provided by this article for nonconformity.

(3) Where a tender has been accepted:

(a) The buyer must within a reasonable time after he discovers or should have discovered any breach, notify the seller of breach or be barred from any remedy; and

(b) If the claim is one for infringement or the like (subsection (3) of section 4-2-312) and the buyer is sued as a result of such a breach, he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

(4) The burden is on the buyer to establish any breach with respect to the goods accepted.

(5) Where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over:

(a) He may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two litigations, then unless the seller after seasonable receipt of the notice does come in and defend, he is so bound.

(b) If the claim is one for infringement or the like (subsection (3) of section 4-2-312), the original seller may demand in writing that his buyer turn over to him control of the litigation including settlement or else be barred from any remedy over and if he also agrees to bear all expense and to satisfy any adverse judgment, then unless the buyer after seasonable receipt of the demand does turn over control, the buyer is so barred.

(6) The provisions of subsections (3), (4), and (5) of this section apply to any obligation of a buyer to hold the seller harmless against infringement or the like (subsection (3) of section 4-2-312).

Source: L. 65: p. 1329, § 1. **C.R.S. 1963:** § 155-2-607.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1) — Section 41, Uniform Sales Act; Subsections (2) and (3) — Sections 49 and 69, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue the prior basic policies with respect to acceptance of goods while making a number of minor though material changes in the interest of simplicity and commercial convenience so that:

1. Under subsection (1), once the buyer accepts a tender the seller acquires a right to its price on the contract terms. In cases of partial acceptance, the price of any part accepted is, if possible, to be reasonably apportioned, using the type of apportionment familiar to the courts in quantum valebat cases, to be determined in terms of "the contract rate," which is the rate determined from the bargain in fact (the agreement) after the rules and policies of this Article have been brought to bear.

2. Under subsection (2) acceptance of goods precludes their subsequent rejection. Any return of the goods thereafter must be by way of revocation of acceptance under the next section. Revocation is unavailable for a non-conformity known to the buyer at the time of acceptance, except where the buyer has accepted on the reasonable assumption that the non-conformity would be seasonably cured.

3. All other remedies of the buyer remain unimpaired under subsection (2). This is intended to include the buyer's full rights with respect to future installments despite his acceptance of any earlier non-conforming installment.

4. The time of notification is to be determined by applying commercial standards to a merchant buyer. "A reasonable time" for notification from a retail consumer is to be judged by different standards so that in his case it will be extended, for the rule of requiring notification is designed to defeat commercial bad faith, not to deprive a good faith consumer of his remedy.

The content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched. There is no reason to require that the notification which saves the buyer's rights under this section must include a clear statement of all the objections that will be relied on by the buyer, as under the section covering statements of defects upon rejection (Section 2-605). Nor is there reason for requiring the notification to be a claim for damages or of any threatened litigation or other resort to a remedy. The notification which saves the buyer's rights under this Article need only be such as informs the seller that the transaction is claimed to involve a breach, and thus opens the way for normal settlement through negotiation.

5. Under this Article various beneficiaries are given rights for injuries sustained by them because of the seller's breach of warranty. Such a beneficiary does not fall within the reason of the present section in regard to discovery of defects and the giving of notice within a reasonable time after acceptance, since he has nothing to do with acceptance. However, the reason of this section does extend to requiring the beneficiary to notify the seller that an injury has occurred. What is said above, with regard to the extended time for reasonable notification from the lay consumer after the injury is also applicable here; but even a beneficiary can be properly held to the use of good faith in notifying, once he has had time to become aware of the legal situation.

6. Subsection (4) unambiguously places the burden of proof to establish breach on the buyer after acceptance. However, this rule becomes one purely of procedure when the tender accepted was non-conforming and the buyer has given the seller notice of breach under subsection (3). For subsection (2) makes it clear that acceptance leaves unimpaired the buyer's right to be made whole, and that right can be exercised by the buyer not only by way of cross-claim for damages, but also by way of recoupment in diminution or extinction of the price.

7. Subsections (3)(b) and (5)(b) give a warrantor against infringement an opportunity to defend or compromise third-party claims or be relieved of his liability. Subsection (5)(a) codifies for all warranties the practice of voucher to defend. Compare Section 3-803. Subsection (6) makes these provisions applicable to the buyer's liability for infringement under Section 2-312.

8. All of the provisions of the present section are subject to any explicit reservation of rights.

Cross References:

Point 1: Section 4-1-201.
Point 2: Section 4-2-608.
Point 4: Sections 4-1-204 and 4-2-605.
Point 5: Section 4-2-318.
Point 6: Section 4-2-717.
Point 7: Sections 4-2-312 and 3-803.
Point 8: Section 4-1-207.

Definitional Cross References:

"Burden of establishing". Section 4-1-201.
"Buyer". Section 4-2-103.
"Conform". Section 4-2-106.
"Contract". Section 4-1-201.
"Goods". Section 4-2-105.
"Notifies". Section 4-1-201.
"Reasonable time". Section 4-1-204.
"Remedy". Section 4-1-201.
"Seasonably". Section 4-1-204.

ANNOTATION

Annotator's note. Since § 4-2-607 is similar to repealed § 121-1-49, CRS 53, and CSA, C. 143A, § 49 (uniform sales act), relevant cases construing this provision have been included in the annotations to this section.

The giving of notice is a condition precedent to a buyer's right to recover for any claimed damage. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963); Hoffman's Double Bar Pine Nursery v. Fyke, 633 P.2d 516 (Colo. App. 1981); Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984).

Notice of breach of warranty is in the nature of a condition precedent to recovery, and generally no remedy is available to the buyer unless notice is given. Rich's Restaurant, Inc. v. McFann Enters., Inc., 39 Colo. App. 545, 570 P.2d 1305 (1977).

Failure to notify seller until after the goods are sold effectively prevents seller from investigating and attempting to cure the alleged defect in the goods. White v. Mississippi Order Buyers, Inc., 648 P.2d 682 (Colo. App. 1982).

Failure to notify seller results in dismissal of breach of warranty claims as a matter of law. Schultz v. Linden-Alimak, Inc., 734 P.2d 146 (Colo. App. 1986).

Whether the notice was given within a reasonable time is a question of fact to be measured by all the circumstances of the case. White v. Mississippi Order Buyers, Inc., 648 P.2d 682 (Colo. App. 1982).

Notice must be within a reasonable time after acceptance. This section provides that if, after acceptance of the goods, the buyer fails to give notice to the seller of the breach of any warranty within a reasonable time when the buyer knows of the breach, the seller shall not be liable therefor. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

The determination of what is a reasonable time for notice of breach depends on the circumstances of each case. Fiberglass Component Prod. v. Reichhold Chems., Inc., 983 F. Supp. 948 (D. Colo. 1997).

The giving of notice may not be after repeated written promises to pay over period of time. Where a purchaser of goods accepts delivery and, after full knowledge of the quality thereof, repeatedly makes written unqualified promises to pay the contract price, which promises continue over a period of time, such a purchaser cannot thereafter be heard to claim damage for late delivery or for breach of warranty as to quality. E. J. Scarry & Co. v. Paper Prods. Co., 122 Colo. 589, 224 P.2d 940 (1950) (period of 90 days); Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963); Cooley v. Big Horn Harvestore Sys., 813 P.2d 736 (Colo. 1991).

There is danger of fraud and false claims even where there is an express warranty, when notice is not early given of the defect; it leads the buyer into temptation. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

Notice requirement of subsection (3)(a) serves three purposes: It provides the seller with an opportunity to correct any defect, to prepare for negotiation and litigation, and to protect itself against stale claims asserted after it is too late for the seller to investigate them. White v. Mississippi Order Buyers, Inc., 648 P.2d 682 (Colo. App. 1982); Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984); Fiberglass Component Prod. v. Reichhold Chems., Inc., 983 F. Supp. 948 (D. Colo. 1997).

The entire purpose of giving notice is to protect the seller; to give him an opportunity to check the complaints. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

The basis for the requirement of notice is to provide an opportunity for the seller to determine whether there is a shortage, to correct the defect, or to effect settlement through negotiation. Rich's Restaurant, Inc. v. McFann Enters., Inc., 39 Colo. App. 545, 570 P.2d 1305 (1977).

In the law governing breach of warranty, the notice requirement serves three useful purposes: First, notice provides the seller a chance to correct any defect; second, notice affords the seller an opportunity to prepare for negotiation and litigation; and third, notice provides the seller a safeguard against stale claims being asserted after it is too late for the manufacturer or seller to investigate them. Prutch v. Ford Motor Co., 618 P.2d 657 (Colo. 1980).

Fairness requires that a buyer should inform the seller if he considers the contract breached and wishes to preserve any remedies; such notice informs the seller the transaction is troublesome and provides him the opportunity to settle the dispute through negotiations. MacGregor v. McReki, Inc., 30 Colo. App. 196, 494 P.2d 1297 (1971).

The buyer has the burden of proof of establishing the fact that notice of a breach of warranty was given to the seller within a reasonable time after he knew, or should have known, that performance of the seller was objectionable. E. J. Scarry & Co. v. Paper Prods. Co., 122 Colo. 589, 224 P.2d 940 (1950); Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

The buyer has the burden of proof that the notice was given within a reasonable time. White v. Mississippi Order Buyers, Inc., 648 P.2d 682 (Colo. App. 1982).

There is adequate and timely notice of the breach where the seller is contacted immediately after an item is installed and told that it is not working. Irrigation Motor & Pump Co. v. Belcher, 29 Colo. App. 343, 483 P.2d 980 (1971).

Where there is no suggestion that the seller suffered any prejudice as a result of not being notified of a breach of warranty at an earlier date, the harsh rule of forfeiture should not be applied. Schlottman v. Pressey, 195 F.2d 343 (10th Cir. 1952).

Notice of breach due to late delivery given prior to delivery is sufficient to preserve the buyer's remedies, and a second notice after acceptance of delivery is not required under the uniform commercial code. This construction best effectuates the purpose of section 4-2-607 and the general obligation of good faith which the uniform commercial code imposes upon the performance and enforcement of contracts in section 4-1-203. MacGregor v. McReki, Inc., 30 Colo. App. 196, 494 P.2d 1297 (1971).

This section does not prescribe the kind or the form of the notice. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

There is no requirement that the notice be formal. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

Communication of defects and of recourse to attorney suffices. Although a formal notice was not given, where the buyer communicated with the seller and notified him of the defects in the goods and the seller acquired firsthand knowledge, the seller could scarcely have concluded that these were mere protests in view of the fact that the buyer had told him that the matter was in the hands of his attorney. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

Where buyer relied on filing of lawsuit for notice to seller under subsection (3)(a), it was error for court to grant seller's motion for summary judgment where federal food and drug administration had sough to ban sale of product and press releases on problems with the product had been issued. Wallman v. Kelley, 976 P.2d 330 (Colo. App. 1998).

There is a distinction between notice of breach under section § 4-2-607(3) and notice of revocation of acceptance under section § 4-2-608(2). Irrigation Motor & Pump Co. v. Belcher, 29 Colo. App. 343, 483 P.2d 980 (1971).

Burden on buyer to prove defects existed at time of sale. The burden is on the buyer seeking to recover damages for defects in quality, or setting up such defects as an affirmative defense in an action for the price, to prove that the defects existed at the time of sale and did not result from deterioration after shipment or from the buyer's negligence after he came into possession of the property, since there is no presumption that the defects discovered after delivery existed at the time of sale. Vanadium Corp. of Am. v. Wesco Stores Co., 135 Colo. 77, 308 P.2d 1011 (1957).

Where seller may have indirect notice of claim, trial court erred in finding, as a matter of law, that delay in giving notice of breach of warranty was unreasonable. Cheyenne Mountain Bank v. Whetstone, 787 P.2d 210 (Colo. App. 1990).

There is no statutorily prescribed format for notice of breach. Hoffman's Double Bar Pine Nursery v. Fyke, 633 P.2d 516 (Colo. App. 1981); Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984); Hawkinson v. A.H. Robins Co., Inc., 595 F. Supp. 1290 (D. Colo. 1984).

Subsection (3)(a) requires notice adequate to permit cure. Hoffman's Double Bar Pine Nursery v. Fyke, 633 P.2d 516 (Colo. App. 1981).

Adequacy of notice is question of fact. Hoffman's Double Bar Pine Nursery v. Fyke, 633 P.2d 516 (Colo. App. 1981); Int'l. Tech. Instruments v. Eng'g Measurements, Inc., 678 P.2d 558 (Colo. App. 1983).

Where seller may have indirect notice of claim, trial court erred in finding, as a matter of law, that delay in giving notice of breach of warranty was unreasonable. Cheyenne Mountain Bank v. Whetstone, 787 P.2d 210 (Colo. App. 1990).

Notice of breach of warranty to remote manufacturer not a condition precedent to purchaser's initiation of litigation against such manufacturer. Cooley v. Big Horn Harvestore Sys., 813 P.2d 736 (Colo. 1991).

Word "seller", as used in subsection (3)(a), construed to refer only to the immediate seller who tendered the goods to the buyer. So long as buyer has given notice of the defect to his immediate seller, no further notification to those distributors beyond the immediate seller is required. Palmer v. A.H. Robins Co., Inc., 684 P.2d 187 (Colo. 1984).

Timely notice of the breach to the immediate seller is all that is required. Separate notice to the seller's supplier or the manufacturer is not necessary. Hawkinson v. A.H. Robins Co., Inc., 595 F. Supp. 1290 (D. Colo. 1984).

Notice of breach given by buyer complied with time parameters of contract notice provision. Myers v. Koop, 757 P.2d 162 (Colo. App. 1988).

Patient gave sufficient notice to physician of defective character of product and such notice "came to the attention" of the physician within the meaning of § 4-1-201 (26), when the patient presented herself to the physician in a life-threatening condition. Palmer v. A.H. Robins Co. Inc., 684 P.2d 187 (Colo. 1984); Hawkinson v. A.H. Robins Co., Inc., 595 F. Supp. 1290 (D. Colo. 1984).

Notice provision not technical procedural barrier to litigation. When the purposes of the notice requirement have been fully served by actual notice, the notice provision should not operate as a technical procedural barrier to deny claimants the opportunity to litigate the case on the merits. Prutch v. Ford Motor Co., 618 P.2d 657 (Colo. 1980).

Notice of breach is legally sufficient when it provides the seller with an opportunity to investigate the buyer's complaint, to correct the alleged defect, or to effect a settlement through negotiation. Int'l. Tech. Instruments v. Eng'g Measurements, Inc., 678 P.2d 558 (Colo. App. 1983).

Failure to provide adequate security agreement constitutes breach. Where the failure of the seller to provide a proper and adequate security agreement directly caused the unconscionable delay in buyer's acquiring titles for vehicles sold, this constituted a breach of the sales contract. Eccher v. Small Bus. Admin., 643 F.2d 1388 (10th Cir. 1981).

Statute as basis for jurisdiction. See Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 129, 574 P.2d 102 (1977).

Applied in Four Sons Bakery v. Dulman, 542 F.2d 829 (10th Cir. 1976); Surplus Electronics Corp. v. Gallin, 653 P.2d 752 (Colo. App. 1982).

4-2-608. Revocation of acceptance in whole or in part. (1) The buyer may revoke his acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to him if he has accepted it:

(a) On the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) Without discovery of such nonconformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

Source: L. 65: p. 1330, § 1. **C.R.S. 1963:** § 155-2-608.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 69(1)(d), (3),,(4) and (5), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

1. Although the prior basic policy is continued, the buyer is no longer required to elect between revocation of acceptance and recovery of damages for breach. Both are now available to him. The non-alternative character of the two remedies is stressed by the terms used in the present section. The section no longer speaks of "rescission," a term capable of ambiguous application either to transfer of title to the goods or to the contract of sale and susceptible also of confusion with cancellation for cause of an executed or executory portion of the contract. The remedy under this section is instead referred to simply as "revocation of acceptance" of goods tendered under a contract for sale and involves no suggestion of "election" of any sort.

2. Revocation of acceptance is possible only where the non-conformity substantially impairs the value of the goods to the buyer. For this purpose the test is not what the seller had reason to know at the time of contracting; the question is whether the non-conformity is such as will in fact cause a substantial impairment of value to the buyer though the seller had no advance knowledge as to the buyer's particular circumstances.

3. "Assurances" by the seller under paragraph (b) of subsection (1) can rest as well in the circumstances or in the contract as in explicit language used at the time of delivery. The reason for recognizing such assurances is that they induce the buyer to delay discovery. These are the only assurances involved in paragraph (b). Explicit assurances may be made either in good faith or bad faith. In either case any remedy accorded by this Article is available to the buyer under the section on remedies for fraud.

4. Subsection (2) requires notification of revocation of acceptance within a reasonable time after discovery of the grounds for such revocation. Since this remedy will be generally resorted to only after attempts at adjustment have failed, the reasonable time period should extend in most cases beyond the time in which notification of breach must be given, beyond the time for discovery of non-conformity after acceptance and beyond the time for rejection after tender. The parties may by their agreement limit the time for notification under this section, but the same sanctions and considerations apply to

such agreements as are discussed in the comment on manner and effect of rightful rejection.

5. The content of the notice under subsection (2) is to be determined in this case as in others by considerations of good faith, prevention of surprise, and reasonable adjustment. More will generally be necessary than the mere notification of breach required under the preceding section. On the other hand the requirements of the section on waiver of buyer's objections do not apply here. The fact that quick notification of trouble is desirable affords good ground for being slow to bind a buyer by his first statement. Following the general policy of this Article, the requirements of the content of notification are less stringent in the case of a non-merchant buyer.

6. Under subsection (2) the prior policy is continued of seeking substantial justice in regard to the condition of goods restored to the seller. Thus the buyer may not revoke his acceptance if the goods have materially deteriorated except by reason of their own defects. Worthless goods, however, need not be offered back and minor defects in the articles reoffered are to be disregarded.

7. The policy of the section allowing partial acceptance is carried over into the present section and the buyer may revoke his acceptance, in appropriate cases, as to the entire lot or any commercial unit thereof.

Cross References:

Point 3: Section 4-2-721.

Point 4: Sections 4-1-204, 4-2-602 and 4-2-607.

Point 5: Sections 4-2-605 and 4-2-607.

Point 7: Section 4-2-601.

Definitional Cross References:

"Buyer". Section 4-2-103.

"Commercial unit". Section 4-2-105.

"Conform". Section 4-2-106.

"Goods". Section 4-2-105.

"Lot". Section 4-2-105.

"Notifies". Section 4-1-201.

"Reasonable time". Section 4-1-204.

"Rights". Section 4-1-201.

"Seasonably". Section 4-1-204.

"Seller". Section 4-2-103.

ANNOTATION

I. GENERAL CONSIDERATION.

Annotator's note. Since § 4-2-608 is similar to repealed § 121-1-69 (1)(e), (3), (4), and (5), C.R.S. 1963, § 121-1-69 (1)(e), (3), (4), and (5), CRS 53, and CSA, C. 143A, §§ 69(1)(e), (3), (4), and (5) (uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

Notice of revocation of acceptance is a recognition by buyer that property belongs to seller. Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

Buyer's counterclaim properly treated as claim to revoke acceptance. A buyer's counterclaim requesting, inter alia, rescission of the contract was properly treated as a claim to revoke acceptance as provided for in this section. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974).

Recovery of purchase price by buyer could not be upheld on theory that buyer had revoked acceptance where sole theory of recovery at trial was based on fraud. Wagner v. Dan Unfug Motors, Inc., 35 Colo. App. 102, 529 P.2d 656 (1974).

Applied in Eccher v. Small Bus. Admin., 643 F.2d 1388 (10th Cir. 1981); Glen Peck, Ltd. v. Fritsche, 651 P.2d 414 (Colo. App. 1981).

II. BUYER MAY REVOKE ACCEPTANCE.

Where a seller of chattels is guilty of a breach of an implied warranty of title, and the purchaser relying upon such warranty has sold or disposed of a minor portion of the chattels, the purchaser, upon learning of the defect of title, may elect to rescind the entire transaction. Koscove v. Brunger, 143 Colo. 354, 352 P.2d 961 (1960); Rudd v. Rogerson, 162 Colo. 103, 424 P.2d 776 (1967).

False representation of material fact, even though innocently made, may merit rescission of a contract or revocation of acceptance. Keen v. Modern Trailer Sales, Inc., 40 Colo. App. 527, 578 P.2d 668 (1978).

Buyer's duty to investigate. A buyer may not revoke acceptance based upon defects which were not known to him at the time of acceptance because of his own failure to make a reasonable investigation which was readily available. Hummel v. Skyline Dodge, Inc., 41 Colo. App. 572, 589 P.2d 73 (1978).

Acceptance of nonconforming articles may be revoked. Revocation of acceptance may occur when the article specified in the contract is so nonconforming that its value to the buyer is substantially impaired. Regents of Univ. of Colo. v. Pacific Pump & Supply, Inc., 35 Colo. App. 36, 528 P.2d 941 (1974).

Buyer may revoke his acceptance of a commercial unit where the nonconformity of the unit substantially impaired its value and the revocation was made in a timely manner. Homier v. Faricy Truck & Equipment Co., 784 P.2d 798 (Colo. App. 1988).

Nonconformity cannot be viewed as a question of the quantity and quality of goods alone, but of the performance of the totality of the seller's contractual undertaking. Regents of Univ. of Colo. v. Pacific Pump & Supply, Inc., 35 Colo. App. 36, 528 P.2d 941 (1974).

Question of impairment under this section turns upon whether the nonconformity is such as will in fact cause a substantial impairment of value to the buyer, regardless of the seller's knowledge of buyer's needs and circumstances. Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

In determining whether goods are substantially impaired, reference must be made to the effect of the goods' nonconformities upon the particular buyer asserting a right of revocation. Jackson v. Rocky Mountain Datsun, Inc., 693 P.2d 391 (Colo. App. 1984).

Buyer must be able to transfer unencumbered title. In order to exercise the remedy of revocation after acceptance, the buyer must, as of the date seller offers to return the purchase price and expenses, or if seller makes no such offer, as of the date the trial court awards buyer this remedy, be in a position to transfer an unencumbered title to the seller. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974).

There is no requirement under the provisions of the UCC that on revocation of acceptance a buyer must deliver title to the goods to the seller. Under § 4-2-711 (3), a buyer retains a security interest in goods in his possession for any payment made on their price and may resell the goods in the same manner as an aggrieved seller. And, where a buyer does not exercise his right of resale, generally all that is required is that the buyer assign to the seller all of his interest in the goods. Jackson v. Rocky Mountain Datsun, Inc., 693 P.2d 391 (Colo. App. 1984).

Remedy is for damages under § 4-2-714. When the buyer has encumbered the title and is not able effectively to transfer the goods to the seller, then buyer's remedy is for damages pursuant to § 4-2-714. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974).

Buyer vested with security interest upon revocation. If a revocation of acceptance of a mobile home is justifiable under this section, § 4-2-711 (3) vests the buyer with a security interest in the home, and such an interest authorizes continued possession to preserve the collateral, pursuant to § 4-9-207 (1) and (4), subject to the seller's right to an offset for the rental value of the home. Keen v. Modern Trailer Sales, Inc., 40 Colo. App. 527, 578 P.2d 668 (1978).

Buyer may revoke acceptance if he accepts goods on the reasonable assumption that a nonconformity will be cured by the seller and the nonconformity is not "seasonably cured". Buyer is not required to provide the seller with an unlimited number of opportunities to cure a nonconformity before revoking acceptance. Jackson v. Rocky Mountain Datsun, Inc., 693 P.2d 391 (Colo. App. 1984).

When the buyer reaccepts goods with the understanding that the seller will cure the defect, the buyer must then afford the seller an opportunity to cure the defect before revoking acceptance or claiming a breach of warranty. Ranta Constr., Inc. v. Anderson, 190 P.3d 835 (Colo. App. 2008).

Buyer was not required to set out in detail the car's nonconformities in her notice of revocation where the buyer had repeatedly notified the dealer of the defective performance of the car and the dealer had made repeated attempts to repair it. Jackson v. Rocky Mountain Datsun, Inc., 693 P.2d 391 (Colo. App. 1984).

Contrary to trial court's determination, there is no "formal notice of revocation" requirement under this section, nor does it exist under § 4-2-607. This section does not require that a revocation of acceptance assume any particular format, but rather that the content of the notice be determined by "considerations of good faith, prevention of surprise, and reasonable adjustment." The notice of revocation, to be sufficient, should fairly apprise the seller that the buyer wants to give back the goods and receive a substitute or money in return. Here, letter that described in detail dryers' alleged defects, attempted to reject acceptance of the dryers, demanded that seller remove the machines from the premises, and requested that damages be paid to buyer and the laundromat owner provided adequate notice of revocation. Cissell Mfg. Co. v. Park, 36 P.3d 85 (Colo. App. 2001).

To prove a valid revocation of acceptance, a buyer must show, among other things, that the goods were nonconforming. Determination of an item's nonconformity hinges on whether it substantially impairs its value to the buyer. Whether goods are nonconforming requires reference to the terms of the contract and the law of warranty. If the goods are contracted for and as warranted, they cannot be nonconforming. Cissell Mfg. Co. v. Park, 36 P.3d 85 (Colo. App. 2001).

III. REASONABLE TIME.

Rescission must be timely and exercised with dispatch upon discovery of the grounds giving rise to the right. Eggen v. M. & K. Trailers & Mobile Home Brokers, Inc., 29 Colo. App. 177, 482 P.2d 435 (1971).

For revocation to be effective, it must occur within a reasonable time. Regents of Univ. of Colo. v. Pacific Pump & Supply, Inc., 35 Colo. App. 36, 528 P.2d 941 (1974); Graham Hydrau-

lic v. Stewart & Stevenson, 797 P.2d 835 (Colo. App. 1990).

What constitutes a reasonable time depends upon the facts of the particular case. Eggen v. M. & K. Trailers & Mobile Homes Brokers, Inc., 29 Colo. App. 177, 482 P.2d 435 (1971).

What is a "reasonable time" during which a buyer can revoke his acceptance is a question of fact to be measured by all the circumstances of the case. Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

Determination of reasonableness of time for revocation is one of fact, to be made on the unique circumstances of each case. Four Sons Bakery v. Dulman, 542 F.2d 829 (10th Cir. 1976).

Sellers cannot complain that rescission is untimely when the delay is caused by their own procrastination and refusal to honor their commitments. Eggen v. M. & K. Trailers & Mobile Home Brokers, Inc., 29 Colo. App. 177, 482 P.2d 435 (1971).

Delay on the part of the buyer will be excused in exercising his right to rescind if it is due to the promises of the seller that the defect will be remedied, or to his requests that further trial be made, or to other acts or declarations of the seller tending to induce delay. Eggen v. M. & K. Trailers & Mobile Home Brokers, Inc., 29 Colo. App. 177, 482 P.2d 435 (1971).

There is a distinction between notice of breach under § 4-2-607(3) and notice of revocation of acceptance under § 4-2-608(2). Irrigation Motor & Pump Co. v. Belcher, 29 Colo. App. 343, 483 P.2d 980 (1971).

Where a buyer gives seller an opportunity to repair an item and withholds revoking acceptance until it became apparent that seller cannot or will not perform its contract, then under such circumstances, a delay in the notice in no way prejudices the seller and is not unreasonable. Irrigation Motor & Pump Co. v. Belcher, 29 Colo. App. 383 P.2d 980 (1971). See Duncan v. Bd. of County Comm'rs, 154 Colo. 447, 391 P.2d 368 (1964).

Buyer was justified in withholding revocation of acceptance until it was apparent that the seller could not perform its obligations under the contract. Regents of Univ. of Colo. v. Pacific Pump & Supply, Inc., 35 Colo. App. 36, 528 P.2d 941 (1974).

Where purchaser kept an automobile and drove it for almost a year after his offer to return it to seller for purchase price and incidental expenses was refused, he lost his right to rescind and recover the full purchase price. Elwood Edwards Auto Sales v. Kinsey, 123 Colo. 52, 225 P.2d 59 (1950).

Delay of one year from date of purchase to date of revocation of acceptance held reasonable. Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

Purchaser's occupancy of mobile home during pendency of suit for rescission does not affect the legitimacy of an attempted revocation of acceptance. Keen v. Modern Trailer Sales, Inc., 40 Colo. App. 527, 578 P.2d 668 (1978).

IV. SAME AS IF GOODS REJECTED.

A rescission renders the contract a nullity, and the parties are put in the position they were in immediately prior to entering into the contract. Eggen v. M. & K. Trailers & Mobile Home Brokers, Inc., 29 Colo. App. 177, 482 P.2d 435 (1971).

Same duties and obligations as if rejected before acceptance. Buyer who asserts a right to revoke acceptance has the same duties and obligations as a buyer who asserts a right to reject the goods before acceptance. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974); Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

After rejection of goods, any exercise of ownership rights is considered wrongful as against the seller. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974).

Purpose of this requirement is to insure that the seller may regain possession of the goods in order to resell the same and minimize his loss. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974).

After revocation buyer holds goods as bailee. Where a buyer is entitled to rescind the sale and elects to do so, the buyer shall thereafter be deemed to hold the goods as a bailee for the seller. Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

Buyer becomes liable for the value of their use. If the buyer after revocation of acceptance uses the goods while he holds them as a bailee, he becomes liable for the value of that use. Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

Deterioration of goods' condition not basis for denying revocation. Deterioration in condition of the goods occurring during the period when seller was attempting to cure defects is not a basis for denying buyer's remedy of revocation. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974).

Where the buyer utilizes the goods as security for a loan which remains unpaid after revocation, this prevents the seller, upon refund of the purchase price and expenses, from reselling the goods to minimize his loss. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974).

4-2-609. Right to adequate assurance of performance. (1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party, the other may in writing demand adequate assurance of due performance and, until he receives such assurance, may if commercially reasonable suspend any performance for which he has not already received the agreed return.

(2) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand, failure to provide within a reasonable time not exceeding thirty days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

Source: L. 65: p. 1331, § 1. **C.R.S. 1963:** § 155-2-609.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See Sections 53, 54(1)(b), 55 and 63(2), Uniform Sales Act.

Purposes:

1. The section rests on the recognition of the fact that the essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit and that a continuing sense of reliance and security that the promised performance will be forthcoming when due, is an important feature of the bargain. If either the willingness or the ability of a party to perform declines materially between the time of contracting and the time for performance, the other party is threatened with the loss of a substantial part of what he has bargained for. A seller needs protection not merely against having to deliver on credit to a shaky buyer, but also against having to procure and manufacture the goods, perhaps turning down other customers. Once he has been given reason to believe that the buyer's performance has become uncertain, it is an undue hardship to force him to continue his own performance. Similarly, a buyer who believes that the seller's deliveries have become uncertain cannot safely wait for the due date of performance when he has been buying to assure himself of materials for his current manufacturing or to replenish his stock of merchandise.

2. Three measures have been adopted to meet the needs of commercial men in such situations. First, the aggrieved party is permitted to suspend his own performance and any preparation therefor, with excuse for any resulting necessary delay, until the situation has been clarified. "Suspend performance" under this section means to hold up performance pending the outcome of the demand, and includes also the holding up of any preparatory action. This is the same principle which governs the ancient law of stoppage and seller's lien, and also of excuse of a buyer from prepayment if the seller's actions manifest that he cannot or will not perform. (Original Act, Section 63(2).)

Secondly, the aggrieved party is given the right to require adequate assurance that the other party's performance will be duly forthcoming. This principle is reflected in the familiar clauses permitting the seller to curtail deliveries if the buyer's credit becomes impaired, which when held within the limits of reasonableness and good faith actually express no more than the fair business meaning of any commercial contract.

Third, and finally, this section provides the means by which the aggrieved party may treat the contract as broken if his reasonable grounds for insecurity are not cleared up within a reasonable time. This is the principle underlying the law of anticipatory breach, whether by way of defective part performance or by repudiation. The present section merges these three principles of law and commercial practice into a single theory of general application to all sales agreements looking to future performance.

3. Subsection (2) of the present section requires that "reasonable" grounds and "adequate" assurance as used in subsection (1) be defined by commercial rather than legal standards. The express reference to commercial standards carries no connotation that the obligation of good faith is not equally applicable here.

Under commercial standards and in accord with commercial practice, a ground for insecurity need not arise from or be directly related to the contract in question. The law as to "dependence" or "independence" of promises within a single contract does not control the application of the present section.

Thus a buyer who falls behind in "his account" with the seller, even though the items involved have to do with separate and legally distinct contracts, impairs the seller's expectation of due performance. Again, under the same test, a buyer who requires precision parts which

he intends to use immediately upon delivery, may have reasonable grounds for insecurity if he discovers that his seller is making defective deliveries of such parts to other buyers with similar needs. Thus, too, in a situation such as arose in Jay Dreher Corporation v. Delco Appliance Corporation, 93 F.2d 275 (C.C.A.2, 1937), where a manufacturer gave a dealer an exclusive franchise for the sale of his product but on two or three occasions breached the exclusive dealing clause, although there was no default in orders, deliveries or payments under the separate sales contract between the parties, the aggrieved dealer would be entitled to suspend his performance of the contract for sale under the present section and to demand assurance that the exclusive dealing contract would be lived up to. There is no need for an explicit clause tying the exclusive franchise into the contract for the sale of goods since the situation itself ties the agreements together.

The nature of the sales contract enters also into the question of reasonableness. For example, a report from an apparently trustworthy source that the seller had shipped defective goods or was planning to ship them would normally give the buyer reasonable grounds for insecurity. But when the buyer has assumed the risk of payment before inspection of the goods, as in a sales contract on C.I.F. or similar cash against documents terms, that risk is not to be evaded by a demand for assurance. Therefore no ground for insecurity would exist under this section unless the report went to a ground which would excuse payment by the buyer.

4. What constitutes "adequate" assurance of due performance is subject to the same test of factual conditions. For example, where the buyer can make use of a defective delivery, a mere promise by a seller of good repute that he is giving the matter his attention and that the defect will not be repeated, is normally sufficient. Under the same circumstances, however, a similar statement by a known corner-cutter might well be considered insufficient without the posting of a guaranty or, if so demanded by the buyer, a speedy replacement of the delivery involved. By the same token where a delivery has defects, even though easily curable, which interfere with easy use by the buyer, no verbal assurance can be deemed adequate which is not accompanied by replacement, repair, money-allowance, or other commercially reasonable cure.

A fact situation such as arose in Corn Products Refining Co. v. Fasola, 94 N.J.L. 181, 109 A. 505 (1920) offers illustration both of reasonable grounds for insecurity and "adequate" assurance. In that case a contract for the sale of oils on 30 days' credit, 2 off for payment within 10 days, provided that credit was to be extended to the buyer only if his financial responsibility was satisfactory to the seller. The buyer had been in the habit of taking advantage of the discount but at the same time that he failed to make his customary 10 day payment, the seller heard rumors, in fact false, that the buyer's financial condition was shaky. Thereupon, the seller demanded cash before shipment or security satisfactory to him. The buyer sent a good credit report from his banker, expressed willingness to make payments when due on the 30 day terms and insisted on further deliveries under the contract. Under this Article the rumors, although false, were enough to make the buyer's financial condition "unsatisfactory" to the seller under the contract clause. Moreover, the buyer's practice of taking the cash discounts is enough, apart from the contract clause, to lay a commercial foundation for suspicion when the practice is suddenly stopped. These matters, however, go only to the justification of the seller's demand for security, or his "reasonable grounds for insecurity".

The adequacy of the assurance given is not measured as in the type of "satisfaction" situation affected with intangibles, such as in personal service cases, cases involving a third party's judgment as final, or cases in which the whole contract is dependent on one party's satisfaction, as in a sale on approval. Here, the seller must exercise good faith and observe commercial standards. This Article thus approves the statement of the court in James B. Berry's Sons Co. of Illinois v. Monark Gasoline & Oil Co., Inc., 32 F.2d 74 (C.C.A.8, 1929), that the seller's satisfaction under such a clause must be based upon reason and must not be arbitrary or capricious; and rejects the purely personal "good faith" test of the Corn Products Refining Co. case, which held that in the seller's sole judgment, if for **any** reason he was dissatisfied, he was entitled to revoke the credit. In the absence of the buyer's failure to take the 2 discount as was his custom, the banker's report given in that case would have been "adequate" assurance under this Act, regardless of the language of the "satisfaction" clause. However, the seller is reasonably entitled to feel insecure at a sudden expansion of the buyer's use of a credit term, and should be entitled either to security or to a satisfactory explanation.

The entire foregoing discussion as to adequacy of assurance by way of explanation is subject to qualification when repeated occasions for the application of this section arise. This Act recognizes that repeated delinquencies must be viewed as cumulative. On the other hand, commercial sense also requires that if repeated claims for assurance are made under this section, the basis for these claims must be increasingly obvious.

5. A failure to provide adequate assurance of performance and thereby to re-establish the security of expectation, results in a breach only "by repudiation" under subsection (4). There-

fore, the possibility is continued of retraction of the repudiation under the section dealing with that problem, unless the aggrieved party has acted on the breach in some manner.

The thirty day limit on the time to provide assurance is laid down to free the question of reasonable time from uncertainty in later litigation.

6. Clauses seeking to give the protected party exceedingly wide powers to cancel or readjust the contract when ground for insecurity arises must be read against the fact that good faith is a part of the obligation of the contract and not subject to modification by agreement and includes, in the case of a merchant, the reasonable observance of commercial standards of fair dealing in the trade. Such clauses can thus be effective to enlarge the protection given by the present section to a certain extent, to fix the reasonable time within which requested assurance must be given, or to define adequacy of the assurance in any commercially reasonable fashion. But any clause seeking to set up arbitrary standards for action is ineffective under this Article. Acceleration clauses are treated similarly in the Articles on Commercial Paper and Secured Transactions.

Cross References:

Point 3: Section 4-1-203.

Point 5: Section 4-2-611.

Point 6: Sections 4-1-203 and 4-1-208 and Articles 3 and 9.

Definitional Cross References:

"Aggrieved party". Section 4-1-201.

"Between merchants". Section 4-2-104.

"Contract". Section 4-1-201.

"Contract for sale". Section 4-2-106.

"Party". Section 4-1-201.

"Reasonable time". Section 4-1-204.

"Rights". Section 4-1-201.

"Writing". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Executory Contracts in Bankruptcy: Protecting the Fundamental Terms of the Bargain", see 54 U. Colo. L. Rev. 507 (1983).

A seller could not suspend performance where his behavior was not such as to bring him within the provisions of this section. Scott v. Crown, 765 P.2d 1043 (Colo. App. 1988).

Whether a party to a contract has reasonable grounds for insecurity and the adequacy of any assurance of performance are questions of fact for the jury. Colo. Interstate Gas Co. v. Chemco, Inc., 854 P.2d 1232 (Colo. 1993).

4-2-610. Anticipatory repudiation. When either party repudiates the contract with respect to a performance not yet due, the loss of which will substantially impair the value of the contract to the other, the aggrieved party may:

(a) For a commercially reasonable time await performance by the repudiating party; or

(b) Resort to any remedy for breach (section 4-2-703 or section 4-2-711), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and

(c) In either case, suspend his own performance or proceed in accordance with the provisions of this article on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (section 4-2-704).

Source: L. 65: p. 1331, § 1. **C.R.S. 1963:** § 155-2-610.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See Sections 63(2) and 65, Uniform Sales Act.

Purposes: To make it clear that:

1. With the problem of insecurity taken care of by the preceding section and with provision being made in this Article as to the effect of a defective delivery under an installment contract, anticipatory repudiation centers upon an overt communication of intention or an action which renders performance impossible or demonstrates a clear determination not to continue with performance.

Under the present section when such a repudiation substantially impairs the value of the contract, the aggrieved party may at any time resort to his remedies for breach, or he may suspend his own performance while he negotiates with, or awaits performance by, the other party. But if he awaits performance beyond a commercially reasonable time he cannot recover resulting damages which he should have avoided.

2. It is not necessary for repudiation that performance be made literally and utterly im-

possible. Repudiation can result from action which reasonably indicates a rejection of the continuing obligation. And, a repudiation automatically results under the preceding section on insecurity when a party fails to provide adequate assurance of due future performance within thirty days after a justifiable demand therefor has been made. Under the language of this section, a demand by one or both parties for more than the contract calls for in the way of counter-performance is not in itself a repudiation nor does it invalidate a plain expression of desire for future performance. However, when under a fair reading it amounts to a statement of intention not to perform except on conditions which go beyond the contract, it becomes a repudiation.

3. The test chosen to justify an aggrieved party's action under this section is the same as that in the section on breach in installment contracts-namely the substantial value of the contract. The most useful test of substantial value is to determine whether material inconvenience or injustice will result if the aggrieved party is forced to wait and receive an ultimate tender minus the part or aspect repudiated.

4. After repudiation, the aggrieved party may immediately resort to any remedy he chooses provided he moves in good faith (see Section 1-203). Inaction and silence by the aggrieved party may leave the matter open but it cannot be regarded as misleading the repudiating party. Therefore the aggrieved party is left free to proceed at any time with his options under this section, unless he has taken some positive action which in good faith requires notification to the other party before the remedy is pursued.

Cross References:

Point 1: Sections 4-2-609 and 4-2-612.
Point 2: Section 4-2-609.
Point 3: Section 4-2-612.
Point 4: Section 4-1-203.

Definitional Cross References:

"Aggrieved party". Section 4-1-201.
"Contract". Section 4-1-201.
"Party". Section 4-1-201.
"Remedy". Section 4-1-201.

ANNOTATION

Applied in Colo. Nat'l Bank v. Bd. of County Comm'rs, 634 P.2d 32 (Colo. 1981); Stone v. Caroselli, 653 P.2d 754 (Colo. App. 1982); Albright v. McDermond, 14 P.3d 318 (Colo. 2000).

4-2-611. Retraction of anticipatory repudiation. (1) Until the repudiating party's next performance is due, he can retract his repudiation, unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

(2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this article (section 4-2-609).

(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

Source: L. 65: p. 1332, § 1. **C.R.S. 1963:** § 155-2-611.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To make it clear that:

1. The repudiating party's right to reinstate the contract is entirely dependent upon the action taken by the aggrieved party. If the latter has cancelled the contract or materially changed his position at any time after the repudiation, there can be no retraction under this section.

2. Under subsection (2) an effective retraction must be accompanied by any assurances demanded under the section dealing with right to adequate assurance. A repudiation is of course sufficient to give reasonable ground for insecurity and to warrant a request for assurance as an essential condition of the retraction. However, after a timely and unambiguous expression of retraction, a reasonable time for the assurance to be worked out should be allowed by the aggrieved party before cancellation.

Cross Reference:

Point 2: Section 4-2-609.

Definitional Cross References:

"Aggrieved party". Section 4-1-201.
"Cancellation". Section 4-2-106.
"Contract". Section 4-1-201.
"Party". Section 4-1-201.
"Rights". Section 4-1-201.

4-2-612. "Installment contract" - breach. (1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) The buyer may reject any installment which is nonconforming if the nonconformity substantially impairs the value of that installment and cannot be cured or if the nonconformity is a defect in the required document; but if the nonconformity does not fall within subsection (3) of this section and the seller gives adequate assurance of its cure, the buyer must accept that installment.

(3) Whenever nonconformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole, but the aggrieved party reinstates the contract if he accepts a nonconforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

Source: L. 65: p. 1332, § 1. **C.R.S. 1963:** § 155-2-612.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 45(2), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue prior law but to make explicit the more mercantile interpretation of many of the rules involved, so that:

1. The definition of an installment contract is phrased more broadly in this Article so as to cover installment deliveries tacitly authorized by the circumstances or by the option of either party.

2. In regard to the apportionment of the price for separate payment this Article applies the more liberal test of what can be apportioned rather than the test of what is clearly apportioned by the agreement. This Article also recognizes approximate calculation or apportionment of price subject to subsequent adjustment. A provision for separate payment for each lot delivered ordinarily means that the price is at least roughly calculable by units of quantity, but such a provision is not essential to an "installment contract." If separate acceptance of separate deliveries is contemplated, no generalized contrast between wholly "entire" and wholly "divisible" contracts has any standing under this Article.

3. This Article rejects any approach which gives clauses such as "each delivery is a separate contract" their legalistically literal effect. Such contracts nonetheless call for installment deliveries. Even where a clause speaks of "a separate contract for all purposes", a commercial reading of the language under the section on good faith and commercial standards requires that the singleness of the document and the negotiation, together with the sense of the situation, prevail over any uncommercial and legalistic interpretation.

4. One of the requirements for rejection under subsection (2) is non-conformity substantially impairing the value of the installment in question. However, an installment agreement may require accurate conformity in quality as a condition to the right to acceptance if the need for such conformity is made clear either by express provision or by the circumstances. In such a case the effect of the agreement is to define explicitly what amounts to substantial impairment of value impossible to cure. A clause requiring accurate compliance as a condition to the right to acceptance must, however, have some basis in reason, must avoid imposing hardship by surprise and is subject to waiver or to displacement by practical construction.

Substantial impairment of the value of an installment can turn not only on the quality of the goods but also on such factors as time, quantity, assortment, and the like. It must be judged in terms of the normal or specifically known purposes of the contract. The defect in required documents refers to such matters as the absence of insurance documents under a C.I.F. contract, falsity of a bill of lading, or one failing to show shipment within the contract period or to the contract destination. Even in such cases, however, the provisions on cure of tender apply if appropriate documents are readily procurable.

5. Under subsection (2) an installment delivery must be accepted if the non-conformity is curable and the seller gives adequate assurance of cure. Cure of non-conformity of an installment in the first instance can usually be afforded by an allowance against the price, or in the case of reasonable discrepancies in quantity either by a further delivery or a partial rejection. This Article requires reasonable action by a buyer in regard to discrepant delivery and good faith requires that the buyer make any reasonable minor outlay of time or money necessary to cure an overshipment by severing out an acceptable percentage thereof. The seller must take over a cure which involves any material burden; the buyer's obligation reaches only to cooperation.

Adequate assurance for purposes of subsection (2) is measured by the same standards as under the section on right to adequate assurance of performance.

6. Subsection (3) is designed to further the continuance of the contract in the absence of an overt cancellation. The question arising when an action is brought as to a single installment only is resolved by making such action waive the right to cancellation. This involves merely a defect in one or more installments, as contrasted with the situation where there is a true repudiation within the section on anticipatory repudiation. Whether the non-conformity in any given installment justifies cancellation as to the future depends, not on whether such non-conformity indicates an intent or likelihood that the future deliveries will also be defective, but whether the non-conformity substantially impairs the value of the whole contract. If only the seller's security in regard to future installments is impaired, he has the right to demand adequate assurances of proper future performance but has not an immediate right to cancel the entire contract. It is clear under this Article, however, that defects in prior installments are cumulative in effect, so that acceptance does not wash out the defect "waived." Prior policy is continued, putting the rule as to buyer's default on the same footing as that in regard to seller's default.

7. Under the requirement of seasonable notification of cancellation under subsection (3), a buyer who accepts a non-conforming installment which substantially impairs the value of the entire contract should properly be permitted to withhold his decision as to whether or not to cancel pending a response from the seller as to his claim for cure or adjustment. Similarly, a seller may withhold a delivery pending payment for prior ones, at the same time delaying his decision as to cancellation. A reasonable time for notifying of cancellation, judged by commercial standard under the section on good faith, extends of course to include the time covered by any reasonable negotiation in good faith. However, during this period the defaulting party is entitled, on request, to know whether the contract is still in effect, before he can be required to perform further.

Cross References:

Point 2: Sections 4-2-307 and 4-2-607.
Point 3: Section 4-1-203.
Point 5: Sections 4-2-208 and 4-2-609.
Point 6: Section 4-2-610.

Definitional Cross References:

"Action". Section 4-1-201.
"Aggrieved party". Section 4-1-201.
"Buyer". Section 4-2-103.
"Cancellation". Section 4-2-106.
"Conform". Section 4-2-106.
"Contract". Section 4-1-201.
"Lot". Section 4-2-105.
"Notifies". Section 4-1-201.
"Seasonably". Section 4-1-204.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "Installment Selling in Colorado and Needed Legislation", see 29 Dicta 81 (1952).

4-2-613. Casualty to identified goods. Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a "no arrival, no sale" term (section 4-2-324), then:

(a) If the loss is total, the contract is avoided; and

(b) If the loss is partial or the goods have so deteriorated as no longer to conform to the contract, the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quantity but without further right against the seller.

Source: L. 65: p. 1332, § 1. **C.R.S. 1963:** § 155-2-613.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 7 and 8, Uniform Sales Act.

Changes: Rewritten, the basic policy being continued but the test of a "divisible" or "indivisible" sale or contract being abandoned in favor of adjustment in business terms.

Purposes of Changes:

1. Where goods whose continued existence is presupposed by the agreement are destroyed without fault of either party, the buyer is relieved from his obligation but may at his option take the surviving goods at a fair adjustment.

"Fault" is intended to include negligence and not merely wilful wrong. The buyer is expressly given the right to inspect the goods in order to determine whether he wishes to avoid the contract entirely or to take the goods with a price adjustment.

2. The section applies whether the goods were already destroyed at the time of contracting without the knowledge of either party or whether they are destroyed subsequently but before the risk of loss passes to the buyer. Where under the agreement, including of course usage of trade, the risk has passed to the buyer before the casualty, the section has no application. Beyond this, the essential question in determining whether the rules of this section are to be applied is whether the seller has or has not undertaken the responsibility for the continued existence of the goods in proper condition through the time of agreed or expected delivery.

3. The section on the term "no arrival, no sale" makes clear that delay in arrival, quite as much as physical change in the goods, gives the buyer the options set forth in this section.

Cross Reference:

Point 3: Section 4-2-324.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Conform". Section 4-2-106.
"Contract". Section 4-1-201.
"Fault". Section 4-1-201.
"Goods". Section 4-2-105.
"Party". Section 4-1-201.
"Rights". Section 4-1-201.
"Seller". Section 4-2-103.

4-2-614. Substituted performance. (1) Where without fault of either party the agreed berthing, loading, or unloading facilities fail, or an agreed type of carrier becomes unavailable, or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive, or predatory.

Source: L. 65: p. 1333, § 1. **C.R.S. 1963:** § 155-2-614.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Subsection (1) requires the tender of a commercially reasonable substituted performance where agreed to facilities have failed or become commercially impracticable. Under this Article, in the absence of specific agreement, the normal or usual facilities enter into the agreement either through the circumstances, usage of trade or prior course of dealing.

This section appears between Section 2-613 on casualty to identified goods and the next section on excuse by failure of presupposed conditions, both of which deal with excuse and complete avoidance of the contract where the occurrence or non-occurrence of a contingency which was a basic assumption of the contract makes the expected performance impossible. The distinction between the present section and those sections lies in whether the failure or impossibility of performance arises in connection with an incidental matter or goes to the very heart of the agreement. The differing lines of solution are contrasted in a comparison of International Paper Co. v. Rockefeller, 161 App.Div. 180, 146 N.Y.S. 371 (1914) and Meyer v. Sullivan, 40 Cal.App. 723, 181 P. 847 (1919). In the former case a contract for the sale of spruce to be cut from a particular tract of land was involved. When a fire destroyed the trees growing on that tract the seller was held excused since performance was impossible. In the latter case the contract called for delivery of wheat "f.o.b. Kosmos Steamer at Seattle." The war led to cancellation of that line's sailing schedule after space had been duly engaged and the buyer was held entitled to demand substituted delivery at the warehouse on the line's loading dock. Under this Article, of course, the seller would also be entitled, had the market gone the other way, to make a substituted tender in that manner.

There must, however, be a true commercial impracticability to excuse the agreed to performance and justify a substituted performance. When this is the case a reasonable substituted performance tendered by either party should excuse him from strict compliance with contract terms which do not go to the essence of the agreement.

2. The substitution provided in this section as between buyer and seller does not carry over into the obligation of a financing agency under a

letter of credit, since such an agency is entitled to performance which is plainly adequate on its face and without need to look into commercial evidence outside of the documents. See Article 5, especially Sections 5-102, 5-103, 5-109, 5-110, 5-114.

3. Under subsection (2) where the contract is still executory on both sides, the seller is permitted to withdraw unless the buyer can provide him with a commercially equivalent return despite the governmental regulation. Where, however, only the debt for the price remains, a larger leeway is permitted. The buyer may pay in the manner provided by the regulation even though this may not be commercially equivalent provided that the regulation is not "discriminatory, oppressive or predatory."

Cross Reference:

Point 2: Article 5.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Fault". Section 4-1-201.
"Party". Section 4-1-201.
"Seller". Section 4-2-103.

4-2-615. Excuse by failure of presupposed conditions. Except so far as a seller may have assumed a greater obligation and subject to section 4-2-614 on substituted performance:

(a) Delay in delivery or nondelivery in whole or in part by a seller who complies with paragraphs (b) and (c) of this section is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency, the nonoccurrence of which was a basic assumption on which the contract was made, or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

(b) Where the causes mentioned in paragraph (a) of this section affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.

(c) The seller must notify the buyer seasonably that there will be a delay or nondelivery and, when allocation is required under paragraph (b) of this section, of the estimated quota thus made available for the buyer.

Source: L. 65: p. 1333, § 1. **C.R.S. 1963:** § 155-2-615.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. This section excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting. The destruction of specific goods and the problem of the use of substituted performance on points other than delay or quantity, treated elsewhere in this Article, must be distinguished from the matter covered by this section.

2. The present section deliberately refrains from any effort at an exhaustive expression of contingencies and is to be interpreted in all cases sought to be brought within its scope in terms of its underlying reason and purpose.

3. The first test for excuse under this Article in terms of basic assumption is a familiar one. The additional test of commercial impracticability (as contrasted with "impossibility," "frustration of performance" or "frustration of the venture") has been adopted in order to call attention to the commercial character of the criterion chosen by this Article.

4. Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section. (See Ford & Sons, Ltd., v. Henry Leetham & Sons, Ltd., 21 Com.Cas. 55 (1915, K.B.D.).)

5. Where a particular source of supply is exclusive under the agreement and fails through casualty, the present section applies rather than the provision on destruction or deterioration of specific goods. The same holds true where a particular source of supply is shown by the circumstances to have been contemplated or assumed by the parties at the time of contract-

ing. (See Davis Co. v. Hoffmann-LaRoche Chemical Works, 178 App.Div. 855, 166 N.Y.S. 179 (1917) and International Paper Co. v. Rockefeller, 161 App.Div. 180, 146 N.Y.S. 371 (1914).) There is no excuse under this section, however, unless the seller has employed all due measures to assure himself that his source will not fail. (See Canadian Industrial Alcohol Co., Ltd., v. Dunbar Molasses Co., 258 N.Y. 194, 179 N.E. 383, 80 A.L.R. 1173 (1932) and Washington Mfg. Co. v. Midland Lumber Co., 113 Wash. 593, 194 P. 777 (1921).)

In the case of failure of production by an agreed source for causes beyond the seller's control, the seller should, if possible, be excused since production by an agreed source is without more a basic assumption of the contract. Such excuse should not result in relieving the defaulting supplier from liability nor in dropping into the seller's lap an unearned bonus of damages over. The flexible adjustment machinery of this Article provides the solution under the provision on the obligation of good faith. A condition to his making good the claim of excuse is the turning over to the buyer of his rights against the defaulting source of supply to the extent of the buyer's contract in relation to which excuse is being claimed.

6. In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of "excuse" or "no excuse," adjustment under the various provisions of this Article is necessary, especially the sections on good faith, on insecurity and assurance and on the reading of all provisions in the light of their purposes, and the general policy of this Act to use equitable principles in furtherance of commercial standards and good faith.

7. The failure of conditions which go to convenience or collateral values rather than to the commercial practicability of the main performance does not amount to a complete excuse. However, good faith and the reason of the present section and of the preceding one may properly be held to justify and even to require any needed delay involved in a good faith inquiry seeking a readjustment of the contract terms to meet the new conditions.

8. The provisions of this section are made subject to assumption of greater liability by agreement and such agreement is to be found not only in the expressed terms of the contract but in the circumstances surrounding the contracting, in trade usage and the like. Thus the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances. (See Madeirense Do Brasil, S.A. v. Stulman-Emrick Lumber Co., 147 F.2d 399 (C.C.A., 2 Cir., 1945).) The exemption otherwise present through usage of trade under the present section may also be expressly negated by the language of the agreement. Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in the light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.

Agreement can also be made in regard to the consequences of exemption as laid down in paragraphs (b) and (c) and the next section on procedure on notice claiming excuse.

9. The case of a farmer who has contracted to sell crops to be grown on designated land may be regarded as falling either within the section on casualty to identified goods or this section, and he may be excused, when there is a failure of the specific crop, either on the basis of the destruction of identified goods or because of the failure of a basic assumption of the contract.

Exemption of the buyer in the case of a "requirements" contract is covered by the "Output and Requirements" section both as to assumption and allocation of the relevant risks. But when a contract by a manufacturer to buy fuel or raw material makes no specific reference to a particular venture and no such reference may be drawn from the circumstances, commercial understanding views it as a general deal in the general market and not conditioned on any assumption of the continuing operation of the buyer's plant. Even when notice is given by the buyer that the supplies are needed to fill a specific contract of a normal commercial kind, commercial understanding does not see such a supply contract as conditioned on the continuance of the buyer's further contract for outlet. On the other hand, where the buyer's contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption as, for instance, a war procurement subcontract known to be based on a prime contract which is subject to termination, or a supply contract for a particular construction venture, the reason of the present section may well apply and entitle the buyer to the exemption.

10. Following its basic policy of using commercial practicability as a test for excuse, this section recognizes as of equal significance either a foreign or domestic regulation and disregards any technical distinctions between "law," "regulation," "order" and the like. Nor does it make the present action of the seller depend upon the eventual judicial determination of the legality of the particular governmental action. The seller's good faith belief in the validity of the regulation is the test under this Article and the best evidence of his good faith is the general commercial acceptance of the regulation. However, governmental interference cannot excuse unless it

truly "supervenes" in such a manner as to be beyond the seller's assumption of risk. And any action by the party claiming excuse which causes or colludes in inducing the governmental action preventing his performance would be in breach of good faith and would destroy his exemption.

11. An excused seller must fulfill his contract to the extent which the supervening contingency permits, and if the situation is such that his customers are generally affected he must take account of all in supplying one. Subsections (a) and (b), therefore, explicitly permit in any proration a fair and reasonable attention to the needs of regular customers who are probably relying on spot orders for supplies. Customers at different stages of the manufacturing process may be fairly treated by including the seller's manufacturing requirements. A fortiori, the seller may also take account of contracts later in date than the one in question. The fact that such spot orders may be closed at an advanced price causes no difficulty, since any allocation which exceeds normal past requirements will not be reasonable. However, good faith requires, when prices have advanced, that the seller exercise real care in making his allocations, and in case of doubt his contract customers should be favored and supplies prorated evenly among them regardless of price. Save for the extra care thus required by changes in the market, this section seeks to leave every reasonable business leeway to the seller.

Cross References:

Point 1: Sections 4-2-613 and 4-2-614.
Point 2: Section 4-1-102.
Point 5: Sections 4-1-203 and 4-2-613.
Point 6: Sections 4-1-102, 4-1-203 and 4-2-609.
Point 7: Section 4-2-614.
Point 8: Sections 4-1-201, 4-2-302 and 4-2-616.
Point 9: Sections 4-1-102, 4-2-306 and 4-2-613.

Definitional Cross References:

"Between merchants". Section 4-2-104.
"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Contract for sale". Section 4-2-106.
"Good faith". Section 4-1-201.
"Merchant". Section 4-2-104.
"Notifies". Section 4-1-201.
"Seasonably". Section 4-1-201.
"Seller". Section 4-2-103.

4-2-616. Procedure on notice claiming excuse. (1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under section 4-2-615, he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this article relating to breach of installment contracts (section 4-2-612), then also as to the whole:

(a) Terminate and thereby discharge any unexecuted portion of the contract; or

(b) Modify the contract by agreeing to take his available quota in substitution.

(2) If after receipt of such notification from the seller the buyer fails so to modify the contract within a reasonable time not exceeding thirty days, the contract lapses with respect to any deliveries affected.

(3) The provisions of this section may not be negated by agreement except insofar as the seller has assumed a greater obligation under section 4-2-615.

Source: L. 65: p. 1334, § 1. **C.R.S. 1963:** § 155-2-616.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

This section seeks to establish simple and workable machinery for providing certainty as to when a supervening and excusing contingency "excuses" the delay, "discharges" the contract, or may result in a waiver of the delay by the buyer. When the seller notifies, in accordance with the preceding section, claiming excuse, the buyer may acquiesce, in which case the contract is so modified. No consideration is necessary in a case of this kind to support such a modification. If the buyer does not elect so to modify the contract, he may terminate it and under subsection (2) his silence after receiving the seller's claim of excuse operates as such a termination. Subsection (3) denies effect to any contract clause made in advance of trouble which would require the buyer to stand ready to take delivery whenever the seller is excused from delivery by unforeseen circumstances.

Cross References:

Point 1: Sections 4-2-209 and 4-2-615.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Installment contract". Section 4-2-612.
"Notification". Section 4-1-201.

"Reasonable time". Section 4-1-204.
"Seller". Section 4-2-103.
"Termination". Section 4-2-106.
"Written". Section 4-1-201.

PART 7

REMEDIES

Law reviews: For article, "An Introduction to the Economic Analysis of Contract Remedies", see 57 U. Colo. L. Rev. 683 (1986).

4-2-701. Remedies for breach of collateral contracts not impaired. Remedies for breach of any obligation or promise collateral or ancillary to a contract for sale are not impaired by the provisions of this article.

Source: L. 65: p. 1334, § 1. **C.R.S. 1963:** § 155-2-701.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes:
Whether a claim for breach of an obligation collateral to the contract for sale requires separate trial to avoid confusion of issues is beyond the scope of this Article; but contractual arrangements which as a business matter enter vitally into the contract should be considered a part thereof in so far as cross-claims or defenses are concerned.
Definitional Cross References:
"Contract for sale". Section 4-2-106.
"Remedy". Section 4-1-201.

4-2-702. Seller's remedies on discovery of buyer's insolvency. (1) Where the seller discovers the buyer to be insolvent, he may refuse delivery except for cash, including payment for all goods theretofore delivered under the contract, and stop delivery under this article (section 4-2-705).

(2) Where the seller discovers that the buyer has received goods on credit while insolvent, he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery, the ten day limitation does not apply. Except as provided in this subsection (2), the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subsection (2) of this section is subject to the rights of a buyer in ordinary course or other good faith purchaser under this article (section 4-2-403). Successful reclamation of goods excludes all other remedies with respect to them.

Source: L. 65: p. 1334, § 1. **C.R.S. 1963:** § 155-2-702. **L. 77:** (3) amended, p. 313, § 7, effective January 1, 1978.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Subsection (1) — Sections 53(1)(b), 54(1)(c) and 57, Uniform Sales Act; Subsection (2) — none; Subsection (3) — Section 76(3), Uniform Sales Act.
Changes: Rewritten, the protection given to a seller who has sold on credit and has delivered goods to the buyer immediately preceding his insolvency being extended.
Purposes of Changes and New Matter: To make it clear that:
1. The seller's right to withhold the goods or to stop delivery except for cash when he discovers the buyer's insolvency is made explicit in subsection (1) regardless of the passage of title, and the concept of stoppage has been extended to include goods in the possession of any bailee who has not yet attorned to the buyer.
2. Subsection (2) takes as its base line the proposition that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and therefore is fraudulent as against the particular seller. This Article makes discovery of the buyer's insolvency and demand within a ten day period a condition of the right to reclaim goods on this

ground. The ten day limitation period operates from the time of receipt of the goods.

An exception to this time limitation is made when a written misrepresentation of solvency has been made to the particular seller within three months prior to the delivery. To fall within the exception the statement of solvency must be in writing, addressed to the particular seller and dated within three months of the delivery.

3. Because the right of the seller to reclaim goods under this section constitutes preferential treatment as against the buyer's other creditors, subsection (3) provides that such reclamation bars all his other remedies as to the goods involved. As amended 1966.

Cross References:

Point 1: Sections 4-2-401 and 4-2-705.

Compare Section 4-2-502.

Definitional Cross References:

"Buyer". Section 4-2-103.

"Buyer in ordinary course of business". Section 4-1-201.

"Contract". Section 4-1-201.

"Good faith". Section 4-1-201.

"Goods". Section 4-2-105.

"Insolvent". Section 4-1-201.

"Person". Section 4-1-201.

"Purchaser". Section 4-1-201.

"Receipt" of goods. Section 4-2-103.

"Remedy". Section 4-1-201.

"Rights". Section 4-1-201.

"Seller". Section 4-2-103.

"Writing". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Commercial Law", see 58 Den. L.J. 279 (1981). For article, "Executory Contracts in Bankruptcy: Protecting the Fundamental Terms of the Bargain", see 54 U. Colo. L. Rev. 507 (1983).

This section is not applicable where there was no credit transaction. Ranchers & Farmers Livestock Auction Co. v. Honey, 38 Colo. App. 69, 552 P.2d 313, cert. dismissed, 191 Colo. 503, 553 P.2d 799 (1976).

Necessary prerequisite to the right to reclaim under this section is a demand for the return of the goods made within 10 days of their receipt. In re Colacci's of Am., 490 F.2d 1118 (10th Cir. 1974).

If the credit seller does not follow up on his rights as to possession, there is a waiver. In re Colacci's of Am., Inc., 490 F.2d 1118 (10th Cir. 1974).

"Follow up" by person seeking to be reclaiming seller means regaining of possession or bona fide attempt to do so. In re Colacci's of Am., Inc., 490 F.2d 1118 (10th Cir. 1974).

Creation of a security interest out of the right to reclaim might allow recovery which would be greater than the mere recovery of goods originally transferred. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Seller was not "reclaiming seller". Where the seller did not act, and instead acquiesced in the buyer's retention of the goods for some four months after they were delivered, although not without some argument and without an expressed consent, and the insistent demands were for payment, and the seller hoped to be paid for the goods during the stalling, and so allowed them to remain at the buyer's, and only after two creditors' meetings did the seller take action to "follow up" its demand, the seller did not become a "reclaiming seller". In re Colacci's of Am., Inc., 490 F.2d 1118 (10th Cir. 1974).

4-2-703. Seller's remedies in general. Where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or the whole, then with respect to any goods directly affected and, if the breach is of the whole contract (section 4-2-612), then also with respect to the whole undelivered balance, the aggrieved seller may:

(a) Withhold delivery of such goods;

(b) Stop delivery by any bailee as hereafter provided (section 4-2-705);

(c) Proceed under section 4-2-704 respecting goods still unidentified to the contract;

(d) Resell and recover damages as hereafter provided (section 4-2-706);

(e) Recover damages for nonacceptance (section 4-2-708) or in a proper case the price (section 4-2-709);

(f) Cancel.

Source: L. 65: p. 1335, § 1. **C.R.S. 1963:** § 155-2-703.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: No comparable index section. See Section 53, Uniform Sales Act.

Purposes:

1. This section is an index section which gathers together in one convenient place all of the various remedies open to a seller for any breach by the buyer. This Article rejects any doctrine of election of remedy as a fundamental policy and thus the remedies are essentially cumulative in nature and include all of the available remedies for breach. Whether the pursuit of one remedy bars another depends entirely on the facts of the individual case.

2. The buyer's breach which occasions the use of the remedies under this section may involve only one lot or delivery of goods, or may involve all of the goods which are the subject matter of the particular contract. The right of the seller to pursue a remedy as to all the goods when the breach is as to only one or more lots is covered by the section on breach in installment contracts. The present section deals only with the remedies available after the goods involved in the breach have been determined by that section.

3. In addition to the typical case of refusal to pay or default in payment, the language in the preamble, "fails to make a payment due," is intended to cover the dishonor of a check on due presentment, or the non-acceptance of a draft, and the failure to furnish an agreed letter of credit.

4. It should also be noted that this Act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (Section 1-106).

Cross References:

Point 2: Section 4-2-612.
Point 3: Section 4-2-325.
Point 4: Section 4-1-106.

Definitional Cross References:

"Aggrieved party". Section 4-1-201.
"Buyer". Section 4-2-103.
"Cancellation". Section 4-2-106.
"Contract". Section 4-1-201.
"Goods". Section 4-2-105.
"Remedy". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "Mechanics' Liens Relative to Oil and Gas Operations — Part II", see 34 Dicta 373 (1957).

Paragraph (f) as a "remedy" of the seller is unrealistic in the face of the filing of the petition for bankruptcy within four months thereafter. The "cancellation" by retaking the goods could not be effective because whatever the action is called, it was still a "transfer" within the meaning of the bankruptcy act "for or on account of an antecedent debt" within four months of the filing of the bankruptcy petition, therefore a preferential transfer. In re Colacci's of Am., Inc., 490 F.2d 1118 (10th Cir. 1974).

Applied in Stone v. Caroselli, 653 P.2d 754 (Colo. App. 1982).

4-2-704. Seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods. (1) An aggrieved seller under section 4-2-703 may:

(a) Identify to the contract conforming goods not already identified if at the time he learned of the breach they are in his possession or control;

(b) Treat as the subject of resale goods which have demonstrably been intended for the particular contract even though those goods are unfinished.

(2) Where the goods are unfinished, an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.

Source: L. 65: p. 1335, § 1. **C.R.S. 1963:** § 155-2-704.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 63(3) and 64(4), Uniform Sales Act.

Changes: Rewritten, the seller's rights being broadened.

Purposes of Changes:

1. This section gives an aggrieved seller the right at the time of breach to identify to the contract any conforming finished goods, regard-

less of their resalability, and to use reasonable judgment as to completing unfinished goods. It thus makes the goods available for resale under the resale section, the seller's primary remedy, and in the special case in which resale is not practicable, allows the action for the price which would then be necessary to give the seller the value of his contract.

2. Under this Article the seller is given express power to complete manufacture or procurement of goods for the contract unless the exercise of reasonable commercial judgment as to the facts as they appear at the time he learns of the breach makes it clear that such action will result in a material increase in damages. The burden is on the buyer to show the commercially unreasonable nature of the seller's action in completing manufacture.

Cross References:

Sections 4-2-703 and 4-2-706.

Definitional Cross References:

"Aggrieved party". Section 4-1-201.
"Conforming". Section 4-2-106.
"Contract". Section 4-1-201.
"Goods". Section 4-2-105.
"Rights". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

For giving notice as condition precedent to seller's recovery, see B. J. Shelton Co. v. Muckle Eng'r Co., 121 Colo. 509, 218 P.2d 1057 (1950) (decided under repealed CSA, C. 143A, § 64(3), uniform sales act).

4-2-705. Seller's stoppage of delivery in transit or otherwise. (1) The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (section 4-2-702), and may stop delivery of carload, truckload, planeload, or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods.

(2) As against such buyer, the seller may stop delivery until:

(a) Receipt of the goods by the buyer; or

(b) Acknowledgment to the buyer by any bailee of the goods except a carrier that the bailee holds the goods for the buyer; or

(c) Such acknowledgment to the buyer by a carrier by reshipment or as a warehouse; or

(d) Negotiation to the buyer of any negotiable document of title covering the goods.

(3) (a) To stop delivery, the seller must so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After such notification, the bailee must hold and deliver the goods according to the directions of the seller, but the seller is liable to the bailee for any ensuing charges or damages.

(c) If a negotiable document of title has been issued for goods, the bailee is not obliged to obey a notification to stop until surrender of possession or control of the document.

(d) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

Source: L. 65: p. 1336, § 1. **C.R.S. 1963:** § 155-2-705. **L. 2006:** (2)(c) and (3)(c) amended, p. 493, § 15, effective September 1.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Sections 57-59, Uniform Sales Act; see also Sections 12, 14, and 42, Uniform Bills of Lading Act and Sections 9, 11, and 49, Uniform Warehouse Receipts Act.

Changes: This section continues and develops the above sections of the Uniform Sales Act in the light of the other uniform statutory provisions noted.

Purposes: To make it clear that:

1. Subsection (1) applies the stoppage principle to other bailees as well as carriers.

It also expands the remedy to cover the situations, in addition to buyer's insolvency, specified in the subsection. But since stoppage is a burden in any case to carriers, and might be a very heavy burden to them if it covered all small shipments in all these situations, the right to stop for reasons other than insolvency is limited to carload, truckload, planeload or larger ship-

ments. The seller shipping to a buyer of doubtful credit can protect himself by shipping C.O.D.

Where stoppage occurs for insecurity it is merely a suspension of performance, and if assurances are duly forthcoming from the buyer the seller is not entitled to resell or divert.

Improper stoppage is a breach by the seller if it effectively interferes with the buyer's right to due tender under the section on manner of tender of delivery. However, if the bailee obeys an unjustified order to stop he may also be liable to the buyer. The measure of his obligation is dependent on the provisions of the Documents of Title Article (Section 7-303). Subsection 3(b) therefore gives him a right of indemnity as against the seller in such a case.

2. "Receipt by the buyer" includes receipt by the buyer's designated representative, the subpurchaser, when shipment is made direct to him and the buyer himself never receives the goods. It is entirely proper under this Article that the seller, by making such direct shipment to the sub-purchaser, be regarded as acquiescing in the latter's purchase and as thus barred from stoppage of the goods as against him.

As between the buyer and the seller, the latter's right to stop the goods at any time until they reach the place of final delivery is recognized by this section.

Under subsection (3)(c) and (d), the carrier is under no duty to recognize the stop order of a person who is a stranger to the carrier's contract. But the seller's right as against the buyer to stop delivery remains, whether or not the carrier is obligated to recognize the stop order. If the carrier does obey it, the buyer cannot complain merely because of that circumstance; and the seller becomes obligated under subsection (3)(b) to pay the carrier any ensuing damages or charges.

3. A diversion of a shipment is not a "reshipment" under subsection (2)(c) when it is merely an incident to the original contract of transportation. Nor is the procurement of "exchange bills" of lading which change only the name of the consignee to that of the buyer's local agent but do not alter the destination of a reshipment.

Acknowledgment by the carrier as a "warehouseman" within the meaning of this Article requires a contract of a truly different character from the original shipment, a contract not in extension of transit but as a warehouseman.

4. Subsection (3)(c) makes the bailee's obedience of a notification to stop conditional upon the surrender of any outstanding negotiable document.

5. Any charges or losses incurred by the carrier in following the seller's orders, whether or not he was obligated to do so, fall to the seller's charge.

6. After an effective stoppage under this section the seller's rights in the goods are the same as if he had never made a delivery.

Cross References:

Sections 4-2-702 and 4-2-703.

Point 1: Sections 4-2-503 and 4-2-609, and Article 7.

Point 2: Section 4-2-103 and Article 7.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Contract for sale". Section 4-2-106.
"Document of title". Section 4-1-201.
"Goods". Section 4-2-105.
"Insolvent". Section 4-1-201.
"Notification". Section 4-1-201.
"Receipt" of goods. Section 4-2-103.
"Rights". Section 4-1-201.
"Seller". Section 4-2-103.

4-2-706. Seller's resale including contract for resale. (1) Under the conditions stated in section 4-2-703 on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this article (section 4-2-710), but less expenses saved in consequence of the buyer's breach.

(2) Except as otherwise provided in subsection (3) of this section or unless otherwise agreed, resale may be at public or private sale, including sale by way of one or more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale including the method, manner, time, place, and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach.

(3) Where the resale is at private sale, the seller must give the buyer reasonable notification of his intention to resell.

(4) Where the resale is at public sale:

(a) Only identified goods can be sold, except where there is a recognized market for a public sale of futures in goods of the kind; and

(b) It must be made at a usual place or market for public sale if one is reasonably available, and, except in the case of goods which are perishable or threaten to decline in

value speedily, the seller must give the buyer reasonable notice of the time and place of the resale; and

(c) If the goods are not to be within the view of those attending the sale, the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders; and

(d) The seller may buy.

(5) A purchaser who buys in good faith at a resale takes the goods free of any rights of the original buyer even though the seller fails to comply with one or more of the requirements of this section.

(6) The seller is not accountable to the buyer for any profit made on any resale. A person in the position of a seller (section 4-2-707) or a buyer who has rightfully rejected or justifiably revoked acceptance must account for any excess over the amount of his security interest, as hereinafter defined (subsection (3) of section 4-2-711).

Source: L. 65: p. 1336, § 1. **C.R.S. 1963:** § 155-2-706.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 60, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To simplify the prior statutory provision and to make it clear that:

1. The only condition precedent to the seller's right of resale under subsection (1) is a breach by the buyer within the section on the seller's remedies in general or insolvency. Other meticulous conditions and restrictions of the prior uniform statutory provision are disapproved by this Article and are replaced by standards of commercial reasonableness. Under this section the seller may resell the goods after any breach by the buyer. Thus, an anticipatory repudiation by the buyer gives rise to any of the seller's remedies for breach, and to the right of resale. This principle is supplemented by subsection (2) which authorizes a resale of goods which are not in existence or were not identified to the contract before the breach.

2. In order to recover the damages prescribed in subsection (1) the seller must act "in good faith and in a commercially reasonable manner" in making the resale. This standard is intended to be more comprehensive than that of "reasonable care and judgment" established by the prior uniform statutory provision. Failure to act properly under this section deprives the seller of the measure of damages here provided and relegates him to that provided in Section 2-708.

Under this Article the seller resells by authority of law, in his own behalf, for his own benefit and for the purpose of fixing his damages. The theory of a seller's agency is thus rejected.

3. If the seller complies with the prescribed standard of duty in making the resale, he may recover from the buyer the damages provided for in subsection (1). Evidence of market or current prices at any particular time or place is relevant only on the question of whether the seller acted in a commercially reasonable manner in making the resale.

The distinction drawn by some courts between cases where the title had not passed to the buyer and the seller had resold as owner, and cases where the title had passed and the seller had resold by virtue of his lien on the goods, is rejected.

4. Subsection (2) frees the remedy of resale from legalistic restrictions and enables the seller to resell in accordance with reasonable commercial practices so as to realize as high a price as possible in the circumstances. By "public" sale is meant a sale by auction. A "private" sale may be effected by solicitation and negotiation conducted either directly or through a broker. In choosing between a public and private sale the character of the goods must be considered and relevant trade practices and usages must be observed.

5. Subsection (2) merely clarifies the common law rule that the time for resale is a reasonable time after the buyer's breach, by using the language "commercially reasonable." What is such a reasonable time depends upon the nature of the goods, the condition of the market and the other circumstances of the case; its length cannot be measured by any legal yardstick or divided into degrees. Where a seller contemplating resale receives a demand from the buyer for inspection under the section of preserving evidence of goods in dispute, the time for resale may be appropriately lengthened.

On the question of the place for resale, subsection (2) goes to the ultimate test, the commercial reasonableness of the seller's choice as to the place for an advantageous resale. This Article rejects the theory that the seller is required to resell at the agreed place for delivery and that a resale elsewhere can be permitted only in exceptional cases.

6. The purpose of subsection (2) being to enable the seller to dispose of the goods to the best advantage, he is permitted in making the resale to depart from the terms and conditions of

the original contract for sale to any extent "commercially reasonable" in the circumstances.

7. The provision of subsection (2) that the goods need not be in existence to be resold applies when the buyer is guilty of anticipatory repudiation of a contract for future goods, before the goods or some of them have come into existence. In such a case the seller may exercise the right of resale and fix his damages by "one or more contracts to sell" the quantity of conforming future goods affected by the repudiation. The companion provision of subsection (2) that resale may be made although the goods were not identified to the contract prior to the buyer's breach, likewise contemplates an anticipatory repudiation by the buyer but occurring after the goods are in existence. If the goods so identified conform to the contract, their resale will fix the seller's damages quite as satisfactorily as if they had been identified before the breach.

8. Where the resale is to be by private sale, subsection (3) requires that reasonable notification of the seller's intention to resell must be given to the buyer. The length of notification of a private sale depends upon the urgency of the matter. Notification of the time and place of this type of sale is not required.

Subsection (4)(b) requires that the seller give the buyer reasonable notice of the time and place of a public resale so that he may have an opportunity to bid or to secure the attendance of other bidders. An exception is made in the case of goods "which are perishable or threaten to decline speedily in value."

9. Since there would be no reasonable prospect of competitive bidding elsewhere, subsection (4) requires that a public resale "must be made at a usual place or market for public sale if one is reasonably available;" i.e., a place or market which prospective bidders may reasonably be expected to attend. Such a market may still be "reasonably available" under this subsection, though at a considerable distance from the place where the goods are located. In such a case the expense of transporting the goods for resale is recoverable from the buyer as part of the seller's incidental damages under subsection (1). However, the question of availability is one of commercial reasonableness in the circumstances and if such "usual" place or market is not reasonably available, a duly advertised public resale may be held at another place if it is one which prospective bidders may reasonably be expected to attend, as distinguished from a place where there is no demand whatsoever for goods of the kind.

Paragraph (a) of subsection (4) qualifies the last sentence of subsection (2) with respect to resales of unidentified and future goods at public sale. If conforming goods are in existence the seller may identify them to the contract after the buyer's breach and then resell them at public sale. If the goods have not been identified, however, he may resell them at public sale only as "future" goods and only where there is a recognized market for public sale of futures in goods of the kind.

The provisions of paragraph (c) of subsection (4) are intended to permit intelligent bidding.

The provision of paragraph (d) of subsection (4) permitting the seller to bid and, of course, to become the purchaser, benefits the original buyer by tending to increase the resale price and thus decreasing the damages he will have to pay.

10. This Article departs in subsection (5) from the prior uniform statutory provision in permitting a good faith purchaser at resale to take a good title as against the buyer even though the seller fails to comply with the requirements of this section.

11. Under subsection (6), the seller retains profit, if any, without distinction based on whether or not he had a lien since this Article divorces the question of passage of title to the buyer from the seller's right of resale or the consequences of its exercise. On the other hand, where "a person in the position of a seller" or a buyer acting under the section on buyer's remedies, exercises his right of resale under the present section he does so only for the limited purpose of obtaining cash for his "security interest" in the goods. Once that purpose has been accomplished any excess in the resale price belongs to the seller to whom an accounting must be made as provided in the last sentence of subsection (6).

Cross References:

Point 1: Sections 4-2-610, 4-2-702 and 4-2-703.

Point 2: Section 4-1-201.

Point 3: Sections 4-2-708 and 4-2-710.

Point 4: Section 4-2-328.

Point 8: Section 4-2-104.

Point 9: Section 4-2-710.

Point 11: Sections 4-2-401, 4-2-707 and 4-2-711(3).

Definitional Cross References:

"Buyer". Section 4-2-103.

"Contract". Section 4-1-201.

"Contract for sale". Section 4-2-106.

"Good faith". Section 4-2-103.

"Goods". Section 4-2-105.

"Merchant". Section 4-2-104.

"Notification". Section 4-1-201.

"Person in position of seller". Section 4-2-707.

"Purchase". Section 4-1-201.

"Rights". Section 4-1-201.

"Sale". Section 4-2-106.

"Security interest". Section 4-1-201.

"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Annotator's note. Since § 4-2-706 is similar to repealed § 121-1-60, CRS 53 (uniform sales act), a relevant case construing this provision of § 4-2-706 has been included in the annotations to this section.

The seller in possession may sell the goods on the buyer's account where the property in the goods has passed to the buyer who then wrongfully refuses to pay for them. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

When seller sells good on buyer's account, the measure of damage is the contract price less the amount of recovery on the resale. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Measure of damage based on contract price less the amount of recovery on resale may differ from damages for nonacceptance. The measure of the seller's claim when based on the contract price less the net proceeds of a resale may in fact be different from the measure of damages provided in the case of nonacceptance of the goods under § 4-2-708 where the measure is the difference between the contract price and the fair market price at the time when the goods ought to have been accepted. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

The seller is bound to exercise reasonable care and judgment in reselling the goods. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

The statutory requirement of reasonable care and judgment is a codification of the common law. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Buyer may not select disadvantageous time to resell. Although a difference in the amount of recovery under this section providing for resale and that of § 4-2-708 providing damages for nonacceptance of goods may exist, it is clear that the statute does not contemplate putting the seller in the position of being able to penalize the buyer by selecting a disadvantageous time to resell the goods. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Initially the burden is on the seller to prove that the resale was made with reasonable care and judgment. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Once the seller has introduced evidence establishing that fairness and good faith was observed, the buyer has the burden of showing that it was not fair and in good faith. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Issue determined by trier of facts. Determination of the issue of whether the resale was made with reasonable care and judgment is for the trier of the facts. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285, (1960).

Proper measure of trade-in upon resale of repossessed vehicle is discussed in A & P Trucking v. Phil Long Ford, Inc., 676 P.2d 1267 (Colo. App. 1984).

4-2-707. "Person in the position of a seller". (1) A "person in the position of a seller" includes as against a principal an agent who has paid or become responsible for the price of goods on behalf of his principal or anyone who otherwise holds a security interest or other right in goods similar to that of a seller.

(2) A person in the position of a seller may as provided in this article withhold or stop delivery (section 4-2-705) and resell (section 4-2-706) and recover incidental damages (section 4-2-710).

Source: L. 65: p. 1337, § 1. **C.R.S. 1963:** § 155-2-707.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 52(2), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

In addition to following in general the prior uniform statutory provision, the case of a financing agency which has acquired documents by honoring a letter of credit for the buyer or by discounting a draft for the seller has been included in the term "a person in the position of a seller."

Cross Reference:

Article 5, Section 4-2-506.

Definitional Cross References:

"Consignee". Section 7-102.

"Consignor". Section 7-102.

"Goods". Section 4-2-105.

"Security interest". Section 4-1-201.

"Seller". Section 4-2-103.

4-2-708. Seller's damages for nonacceptance or repudiation. (1) Subject to subsection (2) of this section and to the provisions of this article with respect to proof of market price (section 4-2-723), the measure of damages for nonacceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price, together with any incidental damages provided in this article (section 4-2-710), but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) of this section is inadequate to put the seller in as good a position as performance would have done, then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this article (section 4-2-710), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

Source: L. 65: p. 1338, § 1. **C.R.S. 1963:** § 155-2-708.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 64, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that:

1. The prior uniform statutory provision is followed generally in setting the current market price at the time and place for tender as the standard by which damages for non-acceptance are to be determined. The time and place of tender is determined by reference to the section on manner of tender of delivery, and to the sections on the effect of such terms as FOB, FAS, CIF, C & F, Ex Ship and No Arrival, No Sale.

In the event that there is no evidence available of the current market price at the time and place of tender, proof of a substitute market may be made under the section on determination and proof of market price. Furthermore, the section on the admissibility of market quotations is intended to ease materially the problem of providing competent evidence.

2. The provision of this section permitting recovery of expected profit including reasonable overhead where the standard measure of damages is inadequate, together with the new requirement that price actions may be sustained only where resale is impractical, are designed to eliminate the unfair and economically wasteful results arising under the older law when fixed price articles were involved. This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods. The normal measure there would be list price less cost to the dealer or list price less manufacturing cost to the manufacturer. It is not necessary to a recovery of "profit" to show a history of earnings, especially of a new venture is involved.

3. In all cases the seller may recover incidental damages.

Cross References:

Point 1: Sections 4-2-319 through 4-2-324, 4-2-503, 4-2-723 and 4-2-724.

Point 2: Section 4-2-709.

Point 3: Section 4-2-710.

Definitional Cross References:

"Buyer". Section 4-2-103.

"Contract". Section 4-1-201.

"Seller". Section 4-2-103.

ANNOTATION

Annotator's note. Since § 4-2-708 is similar to repealed § 121-1-64, CRS 53, and CSA, C. 143A, 64 (uniform sales act), relevant cases construing these provisions have been included in the annotations to this section.

The measure of damages provided in the case of nonacceptance of the goods is the difference between the contract price and the fair market price at the time when the goods ought to have been accepted. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Where buyer wrongfully refuses to accept delivery, the seller's right to retain a down payment is for application on the damages and not addition to them, so if the damages are in excess of such a down payment, only the excess is recoverable. Thach v. Durham, 120 Colo. 253, 208 P.2d 1159 (1949).

Seller's right to apply down payment on damages is not controlling where the seller exercises the right to resell in good faith. Dolfin v. Bruesselbach, 111 Colo. 525, 143 P.2d 1014 (1943).

Seller's recovery by resale under § 4-2-706 may differ from that of this section. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

Where a contract provides for alternative performances, the remedy for its breach is not determined exclusively by the Uniform Commercial Code. The parties to a contract may vary the provisions of the Uniform Commercial Code by agreement, and may provide

for remedies in addition to or in substitution for those provided by the Uniform Commercial Code. Colo. Interstate Gas Co. v. Chemco, Inc., 854 P.2d 1232 (Colo. 1993).

4-2-709. Action for the price. (1) When the buyer fails to pay the price as it becomes due, the seller may recover, together with any incidental damages under section 4-2-710, the price:

(a) Of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and

(b) Of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price, he must hold for the buyer any goods which have been identified to the contract and are still in his control; except, that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (section 4-2-610), a seller who is held not entitled to the price under this section shall nevertheless be awarded damages for nonacceptance under section 4-2-708.

Source: L. 65: p. 1338, § 1. **C.R.S. 1963:** § 155-2-709.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 63, Uniform Sales Act.

Changes: Rewritten, important commercially needed changes being incorporated.

Purposes of Changes: To make it clear that:

1. Neither the passing of title to the goods nor the appointment of a day certain for payment is now material to a price action.

2. The action for the price is now generally limited to those cases where resale of the goods is impracticable except where the buyer has accepted the goods or where they have been destroyed after risk of loss has passed to the buyer.

3. This section substitutes an objective test by action for the former "not readily resalable" standard. An action for the price under subsection (1)(b) can be sustained only after a "reasonable effort to resell" the goods "at reasonable price" has actually been made or where the circumstances "reasonably indicate" that such an effort will be unavailing.

4. If a buyer is in default not with respect to the price, but on an obligation to make an advance, the seller should recover not under this section for the price as such, but for the default in the collateral (though coincident) obligation to finance the seller. If the agreement between the parties contemplates that the buyer will acquire, on making the advance, a security interest in the goods, the buyer on making the advance has such an interest as soon as the seller has rights in the agreed collateral. See Section 9-204.

5. "Goods accepted" by the buyer under subsection (1)(a) include only goods as to which there has been no justified revocation of acceptance, for such a revocation means that there has been a default by the seller which bars his rights under this section. "Goods lost or damaged" are covered by the section on risk of loss. "Goods identified to the contract" under subsection (1)(b) are covered by the section on identification and the section on identification notwithstanding breach.

6. This section is intended to be exhaustive in its enumeration of cases where an action for the price lies.

7. If the action for the price fails, the seller may nonetheless have proved a case entitling him to damages for non-acceptance. In such a situation, subsection (3) permits recovery of those damages in the same action.

Cross References:

Point 4: Section 4-1-106.

Point 5: Sections 4-2-501, 4-2-509, 4-2-510 and 4-2-704.

Point 7: Section 4-2-708.

Definitional Cross References:

"Action". Section 4-1-201.

"Buyer". Section 4-2-103.

"Conforming". Section 4-2-106.

"Contract". Section 4-1-201.

"Goods". Section 4-2-105.

"Seller". Section 4-2-103.

ANNOTATION

Annotator's note. Since § 4-2-709 is similar to repealed § 121-1-63, CRS 53, and CSA, C. 143A, § 63 (uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

This section provides that where the property in the goods has passed to the buyer who then wrongfully refuses to pay for them, the seller may maintain an action for the price of the goods. Howse v. Crumb, 143 Colo. 90, 352 P.2d 285 (1960).

For the giving notice that seller holds goods as "bailee", see B. J. Shelton Co. v. Muckle Eng'r Co., 121 Colo. 509, 218 P.2d 1057 (1950).

Record showing status of sugar market and seller's inventory during relevant period shows efforts to resell would have been unavailing. Great Western Sugar v. Pennant Prods., 748 P.2d 1359 (Colo. App. 1987).

Award of damages using downside pricing was in effect specific performance of the contracts and not a penalty. Great Western Sugar v. Pennant Prods., 748 P.2d 1359 (Colo. App. 1987).

In an action for the price, the seller is entitled to recovery of the price of "goods accepted." However, the Uniform Commercial Code limits the definition of "goods accepted" to "only goods as to which there has been no justified revocation of acceptance, for such a revocation means that there has been a default by the seller which bars the seller's rights under this section." Thus, a procedurally effective rejection or revocation bars acceptance, and revocation of acceptance, like rejection, allows the buyer to avoid the obligation to pay the price. To the extent the trial court determined otherwise in its summary judgment rulings, it was incorrect. Cissell Mfg. Co. v. Park, 36 P.3d 85 (Colo. App. 2001).

Applied in Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 32 Colo. App. 235, 511 P.2d 912 (1973); Nations Enters., Inc. v. Process Equip. Co., 40 Colo. App. 390, 579 P.2d 655 (1978).

4-2-710. Seller's incidental damages. Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses, or commissions incurred in stopping delivery, in the transportation, care, and custody of goods after the buyer's breach, in connection with return or resale of the goods, or otherwise resulting from the breach.

Source: L. 65: p. 1339, § 1. **C.R.S. 1963:** § 155-2-710.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See Sections 64 and 70, Uniform Sales Act.

Purposes: To authorize reimbursement of the seller for expenses reasonably incurred by him as a result of the buyer's breach. The section sets forth the principal normal and necessary additional elements of damage flowing from the breach but intends to allow all commercially reasonable expenditures made by the seller.

Definitional Cross References:

"Aggrieved party". Section 4-1-201.
"Buyer". Section 4-2-103.
"Goods". Section 4-2-105.
"Seller". Section 4-2-103.

ANNOTATION

Cancellation and carrying costs commercially reasonable. Trial court erred in upholding jury award to seller because the jury could have concluded that the seller's charge to the buyer for carrying and cancellation was a reasonable one arising under the express terms of the contract as an expense incurred as a result of the buyer's request to delay shipment. Murray Equipment Co. v. Curtis, Inc., 725 P.2d 35 (Colo. App. 1986).

Absent other statutory or contractual provisions to the contrary, attorney fees are not incidental damages under this section. Jelen and Son, Inc. v. Bandimere, 801 P.2d 1182 (Colo. 1990).

Seller's damages were not incidental to buyer's refusal to accept delivery of chemicals, but instead were incurred as a result of improper storage, handling, and transportation of hazardous materials and subsequent dealings with a third party. Jelen and Son, Inc. v. Bandimere, 801 P.2d 1182 (Colo. 1990).

The focus of this section is upon damages arising within the scope of the immediate con-

tract. Damages must arise as a result of the breach to be characterized as incidental under this section. Jelen and Son, Inc. v. Bandimere, 801 P.2d 1182 (Colo. 1990).

4-2-711. Buyer's remedies in general - buyer's security interest in rejected goods. (1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance, then, with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (section 4-2-612), the buyer may cancel, and, whether or not he has done so, may in addition to recovering so much of the price as has been paid:

(a) "Cover" and have damages under section 4-2-712 as to all the goods affected whether or not they have been identified to the contract; or

(b) Recover damages for nondelivery as provided in this article (section 4-2-713).

(2) Where the seller fails to deliver or repudiates, the buyer may also:

(a) If the goods have been identified, recover them as provided in this article (section 4-2-502); or

(b) In a proper case, obtain specific performance or replevy the goods as provided in this article (section 4-2-716).

(3) On rightful rejection or justifiable revocation of acceptance, a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care, and custody and may hold such goods and resell them in like manner as an aggrieved seller (section 4-2-706).

Source: L. 65: p. 1339, § 1. **C.R.S. 1963:** § 155-2-711.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: No comparable index section; Subsection (3) — Section 69(5), Uniform Sales Act.

Changes: The prior uniform statutory provision is generally continued and expanded in Subsection (3).

Purposes of Changes and New Matter:

1. To index in this section the buyer's remedies, subsection (1) covering those remedies permitting the recovery of money damages, and subsection (2) covering those which permit reaching the goods themselves. The remedies listed here are those available to a buyer who has not accepted the goods or who has justifiably revoked his acceptance. The remedies available to a buyer with regard to goods finally accepted appear in the section dealing with breach in regard to accepted goods. The buyer's right to proceed as to all goods when the breach is as to only some of the goods is determined by the section on breach in installment contracts and by the section on partial acceptance.

Despite the seller's breach, proper retender of delivery under the section on cure of improper tender or replacement can effectively preclude the buyer's remedies under this section, except for any delay involved.

2. To make it clear in subsection (3) that the buyer may hold and resell rejected goods if he has paid a part of the price or incurred expenses of the type specified. "Paid" as used here includes acceptance of a draft or other time negotiable instrument or the signing of a negotiable note. His freedom of resale is coextensive with that of a seller under this Article except that the buyer may not keep any profit resulting from the resale and is limited to retaining only the amount of the price paid and the costs involved in the inspection and handling of the goods. The buyer's security interest in the goods is intended to be limited to the items listed in subsection (3), and the buyer is not permitted to retain such funds as he might believe adequate for his damages. The buyer's right to cover, or to have damages for non-delivery, is not impaired by his exercise of his right of resale.

3. It should also be noted that this Act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (Section 1-106).

Cross References:

Point 1: Sections 4-2-508, 4-2-601(c), 4-2-608, 4-2-612 and 4-2-714.

Point 2: Section 4-2-706.

Point 3: Section 4-1-106.

Definitional Cross References:

"Aggrieved party". Section 4-1-201.

"Buyer". Section 4-2-103.

"Cancellation". Section 4-2-106.

"Contract". Section 4-1-201.

"Cover". Section 4-2-712.

"Goods". Section 4-2-105.

"Notifies". Section 4-1-201.
"Receipt" of goods. Section 4-2-103.
"Remedy". Section 4-1-201.
"Security interest". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "One Year Review of Contracts", see 38 Dicta 161 (1961). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Buyer may recover amount paid. This section provides that where the buyer justifiably revokes acceptance, the buyer may recover so much of the price as he has paid. Irrigation Motor & Pump Co. v. Belcher, 29 Colo. App. 343, 483 P.2d 980 (1971).

The section provides that the buyer has a security interest in goods in his possession or control for any payments made. Irrigation Motor & Pump Co. v. Belcher, 29 Colo. App. 343, 483 P.2d 980 (1971).

Because of buyer's security interest, the buyer is not required to return the goods or to hold them for seller's disposition. Irrigation Motor & Pump Co. v. Belcher, 29 Colo. App. 343, 483 P.2d 980 (1971).

Buyer vested with security interest upon revocation of acceptance. If a revocation of acceptance of a mobile home under § 4-2-608 is justifiable, subsection (3) vests the buyer with a security interest in the home, and such an interest authorizes continued possession to preserve the collateral, pursuant to § 4-9-207 (1) and (4), subject to the seller's right to an offset for the rental value of the home. Keen v. Modern Trailer Sales, Inc., 40 Colo. App. 527, 578 P.2d 668 (1978).

There is no requirement under the provisions of the UCC that on revocation of acceptance a buyer must deliver title to the goods to the seller. Under this section, a buyer retains a security interest in goods in his possession for any payment made on their price and may resell the goods in the same manner as an aggrieved seller. And, where a buyer does not exercise his right of resale, generally all that is required is that the buyer assign to the seller all of his interest in the goods. Jackson v. Rocky Mountain Datsun, Inc., 693 P.2d 391 (Colo. App. 1984).

Failure properly to reject bars recovery of expenses. Where, by failure properly to reject, purchaser is deemed to have accepted the goods, there is no basis for recovery of expenses incident to rejection. Surplus Electronics Corp. v. Gallin, 653 P.2d 752 (Colo. App. 1982).

Statute as basis for jurisdiction. See Stroh v. Am. Recreation & Mobile Home Corp., 35 Colo. App. 196, 530 P.2d 989 (1975).

Applied in Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977); Danburg v. Realties, Inc., 677 P.2d 439 (Colo. App. 1984).

4-2-712. "Cover" - buyer's procurement of substitute goods. (1) After a breach within section 4-2-711, the buyer may "cover" by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of "cover" and the contract price, together with any incidental or consequential damages as hereinafter defined (section 4-2-715), but less expenses saved in consequence of the seller's breach.

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

Source: L. 65: p. 1339, § 1. **C.R.S. 1963:** § 155-2-712.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes:

1. This section provides the buyer with a remedy aimed at enabling him to obtain the goods he needs thus meeting his essential need. This remedy is the buyer's equivalent of the seller's right to resell.

2. The definition of "cover" under subsection (1) envisages a series of contracts or sales, as well as a single contract or sale; goods not identical with those involved but commercially usable as reasonable substitutes under the circumstances of the particular case; and contracts on credit or delivery terms differing from the contract in breach, but again reasonable under the circumstances. The test of proper cover is whether at the time and place the buyer acted in good faith and in a reasonable manner, and it is

immaterial that hindsight may later prove that the method of cover used was not the cheapest or most effective.

The requirement that the buyer must cover "without unreasonable delay" is not intended to limit the time necessary for him to look around and decide as to how he may best effect cover. The test here is similar to that generally used in this Article as to reasonable time and seasonable action.

3. Subsection (3) expresses the policy that cover is not a mandatory remedy for the buyer. The buyer is always free to choose between cover and damages for non-delivery under the next section.

However, this subsection must be read in conjunction with the section which limits the recovery of consequential damages to such as could not have been obviated by cover. Moreover, the operation of the section on specific performance of contracts for "unique" goods must be considered in this connection for availability of the goods to the particular buyer for his particular needs is the test for that remedy and inability to cover is made an express condition to the right of the buyer to replevy the goods.

4. This section does not limit cover to merchants, in the first instance. It is the vital and important remedy for the consumer buyer as well. Both are free to use cover: the domestic or non-merchant consumer is required only to act in normal good faith while the merchant buyer must also observe all reasonable commercial standards of fair dealing in the trade, since this falls within the definition of good faith on his part.

Cross References:

Point 1: Section 4-2-706.

Point 2: Section 4-1-204.

Point 3: Sections 4-2-713, 4-2-715 and 4-2-716.

Point 4: Section 4-1-203.

Definitional Cross References:

"Buyer". Section 4-2-103.

"Contract". Section 4-1-201.

"Good faith". Section 4-2-103.

"Goods". Section 4-2-105.

"Purchase". Section 4-1-201.

"Remedy". Section 4-1-201.

"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "Commercial Law", see 55 Den. L.J. 425 (1978).

Applied in Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977).

4-2-713. Buyer's damages for nondelivery or repudiation. (1) Subject to the provisions of this article with respect to proof of market price (section 4-2-723), the measure of damages for nondelivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this article (section 4-2-715), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender, or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

Source: L. 65: p. 1340, § 1. **C.R.S. 1963:** § 155-2-713.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 67(3), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To clarify the former rule so that:

1. The general baseline adopted in this section uses as a yardstick the market in which the buyer would have obtained cover had he sought that relief. So the place for measuring damages is the place of tender (or the place of arrival if the goods are rejected or their acceptance is revoked after reaching their destination) and the crucial time is the time at which the buyer learns of the breach.

2. The market or current price to be used in comparison with the contract price under this section is the price for goods of the same kind and in the same branch of trade.

3. When the current market price under this section is difficult to prove the section on determination and proof of market price is available to permit a showing of a comparable market price or, where no market price is available, evidence of spot sale prices is proper. Where the unavailability of a market price is caused by a scarcity of goods of the type involved, a good case is normally made for specific performance under this Article. Such scarcity conditions,

moreover, indicate that the price has risen and under the section providing for liberal administration of remedies, opinion evidence as to the value of the goods would be admissible in the absence of a market price and a liberal construction of allowable consequential damages should also result.

4. This section carries forward the standard rule that the buyer must deduct from his damages any expenses saved as a result of the breach.

5. The present section provides a remedy which is completely alternative to cover under the preceding section and applies only when and to the extent that the buyer has not covered.

Cross References:

Point 3: Sections 1-106, 4-2-716 and 4-2-723.
Point 5: Section 4-2-712.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Contract". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "One Year Review of Contracts", see 39 Dicta 161 (1962). For article, "Commercial Law", see 55 Den. L.J. 425 (1978).

Annotator's note. Since § 4-2-713 is similar to repealed § 121-1-67, CRS 53, and CSA, C. 143A, § 67 (uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

Where a corporation refuses to deliver stock pursuant to an option agreement, the price paid for the option is not the measure of damages, and where the stock is available on the market at a much lesser price than that in the option agreement, dismissal for lack of damages is appropriate. Colo. Mgt. Corp. v. Am. Founders Life Ins. Co., 148 Colo. 519, 367 P.2d 335 (1961).

Where there is no mutual rescission of a contract for sale, the buyer cannot recover a down payment if he wrongfully refuses to accept redelivery. Thack v. Durham, 120 Colo. 253, 208 P.2d 1159 (1949).

"Time when buyer learned of the breach" means "time of performance" in anticipatory repudiation cases. Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977).

Damages normally measured from time performance is due. Under this section damages normally should be measured from the time when performance is due and not from the time when the buyer learns of repudiation. Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977).

Under this section a buyer may urge continued performance for a reasonable time. Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977).

After reasonable period, buyer should cover. At the end of a reasonable period during which the buyer may urge continued performance he should cover if substitute goods are readily available. Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977).

Calculation of damages if buyer cannot cover. If a valid reason exists for failure or refusal to cover after the reasonable time for urging continued performance is over, damages may be calculated from the time when performance is due. Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977).

Calculation if buyer could but does not cover. If after a reasonable time during which a buyer urges continued performance substitution is readily available and buyer does not cover within a reasonable time, damages should be based on the price at the end of that reasonable time rather than on the price when performance is due. Cargill, Inc. v. Stafford, 553 F.2d 1222 (10th Cir. 1977).

Applied in William B. Tanner Co. v. Mesa Broad. Co., 575 F. Supp. 1501 (D. Colo. 1983).

4-2-714. Buyer's damages for breach in regard to accepted goods. (1) Where the buyer has accepted goods and given notification (subsection (3) of section 4-2-607), he may recover as damages for any nonconformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case, any incidental and consequential damages under section 4-2-715 may also be recovered.

Source: L. 65: p. 1340, § 1. **C.R.S. 1963:** § 155-2-714.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Section 69(6) and (7), Uniform Sales Act.
Changes: Rewritten.
Purposes of Changes:

1. This section deals with the remedies available to the buyer after the goods have been accepted and the time for revocation of acceptance has gone by. In general this section adopts the rule of the prior uniform statutory provision for measuring damages where there has been a breach of warranty as to goods accepted, but goes further to lay down an explicit provision as to the time and place for determining the loss.

The section on deduction of damages from price provides an additional remedy for a buyer who still owes part of the purchase price, and frequently the two remedies will be available concurrently. The buyer's failure to notify of his claim under the section on effects of acceptance, however, operates to bar his remedies under either that section or the present section.

2. The "non-conformity" referred to in subsection (1) includes not only breaches of warranties but also any failure of the seller to perform according to his obligations under the contract. In the case of such non-conformity, the buyer is permitted to recover for his loss "in any manner which is reasonable."

3. Subsection (2) describes the usual, standard and reasonable method of ascertaining damages in the case of breach of warranty but it is not intended as an exclusive measure. It departs from the measure of damages for non-delivery in utilizing the place of acceptance rather than the place of tender. In some cases the two may coincide, as where the buyer signifies his acceptance upon the tender. If, however, the non-conformity is such as would justify revocation of acceptance, the time and place of acceptance under this section is determined as of the buyer's decision not to revoke.

4. The incidental and consequential damages referred to in subsection (3), which will usually accompany an action brought under this section, are discussed in detail in the comment on the next section.

Cross References:

Point 1: Compare Section 4-2-711; Sections 4-2-607 and 4-2-717.
Point 2: Section 4-2-106.
Point 3: Sections 4-2-608 and 4-2-713.
Point 4: Section 4-2-715.

Definitional Cross References:

"Buyer". Section 4-2-103.
"Conform". Section 4-2-106.
"Goods". Section 4-1-201.
"Notification". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

I. GENERAL CONSIDERATION.

Annotator's note. Since § 4-2-714 is similar to repealed §§ 121-1-69(1)(c), (6), and (7), C.R.S. 1963, §§ 121-1-69(1)(b), (6), and (7), CRS 53, and CSA, C. 143A, §§ 69(1)(b), (6), and (7)(uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

Applied in Duncan v. Schuster-Graham Homes, Inc., 194 Colo. 441, 578 P.2d 637 (1978); Western Conference Resorts, Inc. v. Pease, 668 P.2d 973 (Colo. App. 1983).

II. BUYER MAY RECOVER.

The acceptance and retention of goods by a purchaser does not defeat his action for damages for breach of warranty. Platte Valley Motor Co. v. Wagner, 130 Colo. 365, 278 P.2d 870 (1954).

This section permits acceptance and retention of the goods and maintenance of an action for breach of warranty. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

Seller still liable for misrepresentation. Acceptance of goods does not relieve seller from liability for damages caused by misrepresentation where there is an express warranty. Schlottman v. Pressey, 195 F.2d 343 (10th Cir. 1952), rev'g 96 F. Supp. 979 (D. Colo. 1951).

When a buyer's claim is based exclusively upon an express warranty, the measure of damages is the loss directly and naturally resulting in the ordinary course of events from the breach of warranty as provided in subsection (1) of this section. Schlottman v. Pressey, 195 F.2d 343 (10th Cir. 1952).

Seller is bound to foresee injuries which follow a breach of contract in the usual course of events, and it is not necessary for a buyer to show specifically that the seller had knowledge of the facts. Thus when the goods are sold for consumption and use, the seller is then held to foresee and anticipate injuries which may result from breach of the contract of sale if the goods are put to their customary consumption and use; such injuries are said to be the natural result of the breach. Schlottman v. Pressey, 195 F.2d 343 (10th Cir. 1952).

A buyer is within his rights in asserting a recoupment remedy for those damages which are directly and naturally attributable to the deficiencies of the goods; other damages directly and naturally resulting from the breach of warranty can be claimed by way of counterclaim. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

When the buyer has encumbered the title and is not able effectively to transfer the goods to the seller, then buyer's remedy is for damages pursuant to this section. Moeller Mfg., Inc. v. Mattis, 33 Colo. App. 300, 519 P.2d 1218 (1974).

Award of replacement cost of defective part insufficient. Where there is a "latent defect" which cannot be corrected simply by replacing a defective part and awarding the costs of replacing that part would not make the aggrieved party whole, an award of the entire value of the product damaged is appropriate. Gibbons v. Windish, Inc., 662 P.2d 500 (Colo. App. 1983).

Under "special circumstances", consequential damages may be recovered. Prutch v. Ford Motor Co., 40 Colo. App. 129, 574 P.2d 102 (1977), rev'd on other grounds, 618 P.2d 657 (Colo. 1980).

Where a buyer's use of a product which he knows is defective is foreseeable, the seller's liability for consequential damages is not cut off. Prutch v. Ford Motor Co., 40 Colo. App. 129, 574 P.2d 102 (1977), rev'd on other grounds, 618 P.2d 657 (Colo. 1980).

III. MEASURE OF DAMAGES.

The proper measure for breach of warranty of quality is the difference between the value of the goods at the time of delivery to the buyer and the value they would have had had they complied with the warranty. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963); Converse v. Zinke, 635 P.2d 882 (Colo. 1981).

The basic measure of damages for breach of warranty under subsection (2) is the difference between the value of the goods accepted and the value of the goods as warranted. Prutch v. Ford Motor Co., 40 Colo. App. 129, 574 P.2d 102 (1977), rev'd on other grounds, 618 P.2d 657 (Colo. 1980).

Any duty buyers may have to mitigate their damages is fully discharged by repeated efforts to persuade the seller to repair the goods. Cherokee Inv. Co. v. Voiles, 166 Colo. 270, 443 P.2d 727 (1968).

Buyer may recover full obligation while retaining goods where no salvage value. The argument that buyers, by recovering their full obligation while still retaining inoperative goods, are placed in a better position than they contracted for is not supported where there is not any evidence indicating that the goods in their present condition have any salvage value. Cherokee Inv. Co. v. Voiles, 166 Colo. 270, 443 P.2d 727 (1968).

Section clearly permits approximations as to extent of damage, providing the fact of damage or lost profits is certain. Eccher v. Small Bus. Admin., 643 F.2d 1388 (10th Cir. 1981).

Court's determination of damages will not be disturbed on appeal unless clearly erroneous. Eccher v. Small Bus. Admin., 643 F.2d 1388 (10th Cir. 1981).

4-2-715. Buyer's incidental and consequential damages. (1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses, or commissions in connection with effecting "cover" and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include:

(a) Any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) Injury to person or property proximately resulting from any breach of warranty.

Source: L. 65: p. 1340, § 1. **C.R.S. 1963:** § 155-2-715.

OFFICIAL COMMENT

Prior Uniform Statutory Provisions: Subsection (2)(b) — Sections 69(7) and 70, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes and New Matter:

1. Subsection (1) is intended to provide reimbursement for the buyer who incurs reasonable expenses in connection with the handling of rightfully rejected goods or goods whose acceptance may be justifiably revoked, or in connection with effecting cover where the breach of the contract lies in non-conformity or non-delivery of the goods. The incidental damages listed are not intended to be exhaustive but are merely

illustrative of the typical kinds of incidental damage.

2. Subsection (2) operates to allow the buyer, in an appropriate case, any consequential damages which are the result of the seller's breach. The "tacit agreement" test for the recovery of consequential damages is rejected. Although the older rule at common law which made the seller liable for all consequential damages of which he had "reason to know" in advance is followed, the liberality of that rule is modified by refusing to permit recovery unless the buyer could not reasonably have prevented the loss by cover or otherwise. Subparagraph (2) carries forward the provisions of the prior uniform statutory provision as to consequential damages resulting from breach of warranty, but modifies the rule by requiring first that the buyer attempt to minimize his damages in good faith, either by cover or otherwise.

3. In the absence of excuse under the section on merchant's excuse by failure of presupposed conditions, the seller is liable for consequential damages in all cases where he had reason to know of the buyer's general or particular requirements at the time of contracting. It is not necessary that there be a conscious acceptance of an insurer's liability on the seller's part, nor is his obligation for consequential damages limited to cases in which he fails to use due effort in good faith.

Particular needs of the buyer must generally be made known to the seller while general needs must rarely be made known to charge the seller with knowledge.

Any seller who does not wish to take the risk of consequential damages has available the section on contractual limitation of remedy.

4. The burden of proving the extent of loss incurred by way of consequential damage is on the buyer, but the section on liberal administration of remedies rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances.

5. Subsection (2)(b) states the usual rule as to breach of warranty, allowing recovery for injuries "proximately" resulting from the breach. Where the injury involved follows the use of goods without discovery of the defect causing the damage, the question of "proximate" cause turns on whether it was reasonable for the buyer to use the goods without such inspection as would have revealed the defects. If it was not reasonable for him to do so, or if he did in fact discover the defect prior to his use, the injury would not proximately result from the breach of warranty.

6. In the case of sale of wares to one in the business of reselling them, resale is one of the requirements of which the seller has reason to know within the meaning of subsection (2)(a).

Cross References:

Point 1: Section 4-2-608.

Point 3: Sections 4-1-203, 4-2-615 and 4-2-719.

Point 4: Section 4-1-106.

Definitional Cross References:

"Cover". Section 4-2-712.

"Goods". Section 4-1-201.

"Person". Section 4-1-201.

"Receipt" of goods. Section 4-2-103.

"Seller". Section 4-2-103.

ANNOTATION

Annotator's note. Since § 4-2-715 is similar to repealed § 121-1-70, C.R.S. 1963, and § 121-1-70, CRS 53 (uniform sales act), relevant cases construing those provisions have been included in the annotations to this section.

Interest and carrying charges are consequential damages. Where the goods purchased are entirely worthless and the only way buyer can be made whole is by awarding him the full amount of the obligation he undertook to pay at the time he purchased the goods, then the interest and carrying charges incurred at the time the sale was made are clearly consequential damages directly resulting from the breach of warranty. Cherokee Inv. Co. v. Voiles, 166 Colo. 270, 443 P.2d 727 (1968).

Special damages where machine is unsuitable. Where there is a breach of a special warranty whereby a seller undertakes to build a machine suitable for a mass production purpose, the buyer is entitled to special damages for its expenditure in the manufacture of the tools and dies to be used with the machine and to those expenditures reasonably attributed to efforts to adjust and repair the machine before the date when notice of breach of warranty was given to the buyer. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

The claim of a buyer for damages for loss of profits cannot be allowed where these were not sufficiently proven and where they are in law remote. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963).

Code rejects "tacit agreement" test. The Colorado statutory scheme rejects the "tacit agreement" test that would permit consequential damages only if the seller specifically contemplated or actually assumed the risk of such damages. Prutch v. Ford Motor Co., 618 P.2d 657 (Colo. 1980).

The element which triggers recovery of consequential damages under subsection (2)(a) is foreseeability. Subsection (2)(a) means that consequential damages are recoverable whenever those damages were reasonably fore-

seeable by the seller when he entered the contract. Prutch v. Ford Motor Co., 40 Colo. App. 129, 574 P.2d 102 (1977), rev'd on other grounds, 618 P.2d 657 (Colo. 1980).

Where a buyer's use of a product which he knows is defective is foreseeable, the seller's liability for consequential damages is not cut off. Prutch v. Ford Motor Co., 40 Colo. App. 129, 574 P.2d 102 (1977), rev'd on other grounds, 618 P.2d 657 (Colo. 1980).

A manufacturer knowing that its products will be used for crop production reasonably can be expected to foresee that defects in those products may cause crop losses. Prutch v. Ford Motor Co., 618 P.2d 657 (Colo. 1980).

"Reason to know" formulation not exclusive remedy in fraud suits. The code does not require that the "reason to know" formulation be applied in fraud suits to the exclusion of other remedies; it only provides that the remedies available under the "reason to know" formulation are included among the remedies available to a defrauded purchaser. Wagner v. Dan Unfug Motors, Inc., 35 Colo. App. 102, 529 P.2d 656 (1974).

Attempt to mitigate losses not intervening cause of damages. Where plaintiffs, in deciding to continue farming with the knowledge that their equipment might continue to malfunction, actually mitigated their losses, their decision to try to produce at least part of a normal crop, rather than no crop at all, was required by their "duty to lessen, rather than increase", their damages and was not an intervening cause of damages. Prutch v. Ford Motor Co., 618 P.2d 657 (Colo. 1980).

Section clearly permits approximations as to extent of damage, providing the fact of damage or lost profits is certain. Eccher v. Small Bus. Admin., 643 F.2d 1388 (10th Cir. 1981).

Proof of true value of the goods as compared to the contract price is relevant where a warranty remedy is sought. Power Equip. Co. v. Fulton, 32 Colo. App. 430, 513 P.2d 234 (1973).

Court's determination of damages will not be disturbed on appeal unless clearly erroneous. Eccher v. Small Bus. Admin., 643 F.2d 1388 (10th Cir. 1981).

Error of omission in instructing on warranty theory of liability. Where the jury specifically rejected a warranty theory of liability, any error of omission in instructing on this theory is harmless error. Power Equip. Co. v. Fulton, 32 Colo. App. 430, 513 P.2d 234 (1973).

Evidence of loss of profit is admissible in determining amount of consequential damages if the prospective loss has been shown with reasonable certainty. Cope v. Vermeer Sales, 650 P.2d 1307 (Colo. App. 1982); Int'l. Tech. Instruments v. Eng'g Measurements, Inc., 678 P.2d 558 (Colo. App. 1983).

But the absence of prior profits in a newly established business does not create a "per se" exclusion of loss of profit as an item of damages if sufficient competent evidence is proffered. Cope v. Vermeer Sales, 650 P.2d 1307 (Colo. App. 1982); Int'l. Tech. Instruments v. Eng'g Measurements, Inc., 678 P.2d 558 (Colo. App. 1983).

This section specifically allows buyers to recover consequential damages resulting from the seller's breach. There is no corresponding provision in the code allowing the seller to recover consequential damages. Jelen and Son, Inc. v. Bandimere, 801 P.2d 1182 (Colo. 1990).

Applied in Caldwell v. Kats, 38 Colo. App. 156, 555 P.2d 190 (1976); Duncan v. Schuster-Graham Homes, Inc., 194 Colo. 441, 578 P.2d 637 (1978); Cement Asbestos Prods. Co. v. Hartford Accident & Indem. Co., 592 F.2d 1144 (10th Cir. 1979); Western Conference Resorts, Inc. v. Pease, 668 P.2d 973 (Colo. App. 1983).

4-2-716. Buyer's right to specific performance or replevin. (1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he or she is unable to effect "cover" for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered. In the case of goods bought for personal, family, or household purposes, the buyer's right of replevin vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

Source: L. 65: p. 1341, § 1. **C.R.S. 1963:** § 155-2-716. **L. 2001:** (3) amended, p. 1438, § 22, effective July 1.

OFFICIAL COMMENT

1. The present section continues in general prior policy as to specific performance and injunction against breach. However, without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article seeks to further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of sale.

2. In view of this Article's emphasis on the commercial feasibility of replacement, a new concept of what are "unique" goods is introduced under this section. Specific performance is no longer limited to goods which are already specific or ascertained at the time of contracting. The test of uniqueness under this section must be made in terms of the total situation which characterizes the contract. Output and requirements contracts involving a particular or peculiarly available source or market present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief may also be granted "in other proper circumstances" and inability to cover is strong evidence of "other proper circumstances".

3. The legal remedy of replevin is given the buyer in cases in which cover is reasonably unavailable and goods have been identified to the contract. This is in addition to the buyer's right to recover identified goods on the seller's insolvency (Section 2-502).

4. This section is intended to give the buyer rights to the goods comparable to the seller's rights to the price.

5. If a negotiable document of title is outstanding, the buyer's right of replevin relates of course to the document not directly to the goods. See Article 7, especially Section 7-602.

Cross References:
Point 3: Section 4-2-502.
Point 4: Section 4-2-709.
Point 5: Article 7.

Definitional Cross References:
"Buyer". Section 4-2-103.
"Goods". Section 4-1-201.
"Rights". Section 4-1-201.

ANNOTATION

Applied in Colorado-Ute Elec. Ass'n v. Envirotech Corp., 524 F. Supp. 1152 (D. Colo. 1981).

4-2-717. Deduction of damages from the price. The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract.

Source: L. 65: p. 1341, § 1. **C.R.S. 1963:** § 155-2-717.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: See Section 69(1)(a), Uniform Sales Act.

Purposes:

1. This section permits the buyer to deduct from the price damages resulting from any breach by the seller and does not limit the relief to cases of breach of warranty as did the prior uniform statutory provision. To bring this provision into application the breach involved must be of the same contract under which the price in question is claimed to have been earned.

2. The buyer, however, must give notice of his intention to withhold all or part of the price if he wishes to avoid a default within the meaning of the section on insecurity and right to assurances. In conformity with the general policies of this Article, no formality of notice is required and any language which reasonably indicates the buyer's reason for holding up his payment is sufficient.

Cross Reference:
Point 2: Section 4-2-609.

Definitional Cross References:
"Buyer". Section 4-2-103.
"Notifies". Section 4-1-201.

ANNOTATION

This section allows the buyer to accept the goods and to assert a breach of warranty by way of recoupment in diminution or extinction of the price. Comet Indus., Inc. v. Best Plastic Container Corp., 222 F. Supp. 723 (D. Colo. 1963) (decided under repealed § 121-1-69(1)(a), CRS 53, uniform sales act).

4-2-718. Liquidation or limitation of damages - deposits. (1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds:

(a) The amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1) of this section; or

(b) In the absence of such terms, twenty percent of the value of the total performance for which the buyer is obligated under the contract or five hundred dollars, whichever is smaller.

(3) The buyer's right to restitution under subsection (2) of this section is subject to offset to the extent that the seller establishes:

(a) A right to recover damages under the provisions of this article other than subsection (1) of this section, and

(b) The amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(4) Where a seller has received payment in goods, their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2) of this section; but if the seller has notice of the buyer's breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this article on resale by an aggrieved seller (section 4-2-706).

Source: L. 65: p. 1341, § 1. **C.R.S. 1963:** § 155-2-718.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes:

1. Under subsection (1) liquidated damage clauses are allowed where the amount involved is reasonable in the light of the circumstances of the case. The subsection sets forth explicitly the elements to be considered in determining the reasonableness of a liquidated damage clause. A term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses.

2. Subsection (2) refuses to recognize a forfeiture unless the amount of the payment so forfeited represents a reasonable liquidation of damages as determined under subsection (1). A special exception is made in the case of small amounts (20% of the price or $500, whichever is smaller) deposited as security. No distinction is made between cases in which the payment is to be applied on the price and those in which it is intended as security for performance. Subsection (2) is applicable to any deposit or down or part payment. In the case of a deposit or turn in of goods resold before the breach, the amount actually received on the resale is to be viewed as the deposit rather than the amount allowed the buyer for the trade in. However, if the seller knows of the breach prior to the resale of the goods turned in, he must make reasonable efforts to realize their true value, and this is assured by requiring him to comply with the conditions laid down in the section on resale by an aggrieved seller.

Cross References:
Point 1: Section 4-2-302.
Point 2: Section 4-2-706.

Definitional Cross References:
"Aggrieved party". Section 4-1-201.
"Agreement". Section 4-1-201.
"Buyer". Section 4-2-103.
"Goods". Section 4-2-105.
"Notice". Section 4-1-201.

"Party". Section 4-1-201.
"Remedy". Section 4-1-201.
"Seller". Section 4-2-103.
"Term". Section 4-1-201.

ANNOTATION

Law reviews. For article, "Exclusion and Modification of Warranty under the U.C.C. — How to Succeed in Business Without Being Liable for Not Really Trying", see 46 Den. L.J. 579 (1969).

4-2-719. Contractual modification or limitation of remedy. (1) Subject to the provisions of subsections (2) and (3) of this section and of section 4-2-718 on liquidation and limitation of damages:

(a) The agreement may provide for remedies in addition to or in substitution for those provided in this article and may limit or alter the measure of damages recoverable under this article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of nonconforming goods or parts; and

(b) Resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case, it is the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this title.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable, but limitation of damages where the loss is commercial is not.

Source: L. 65: p. 1342, § 1. **C.R.S. 1963:** § 155-2-719.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes:

1. Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect.

However, it is of the very essence of a sales contract that at least minimum adequate remedies be available. If the parties intend to conclude a contract for sale within this Article they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract. Thus any clause purporting to modify or limit the remedial provisions of this Article in an unconscionable manner is subject to deletion and in that event the remedies made available by this Article are applicable as if the stricken clause had never existed. Similarly, under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article.

2. Subsection (1)(b) creates a presumption that clauses prescribing remedies are cumulative rather than exclusive. If the parties intend the term to describe the sole remedy under the contract, this must be clearly expressed.

3. Subsection (3) recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner. Actually such terms are merely an allocation of unknown or undeterminable risks. The seller in all cases is free to disclaim warranties in the manner provided in Section 2-316.

Cross References:

Point 1: Section 4-2-302.
Point 3: Section 4-2-316.

Definitional Cross References:

"Agreement". Section 4-1-201.
"Buyer". Section 4-2-103.
"Conforming". Section 4-2-106.
"Contract". Section 4-1-201.
"Goods". Section 4-2-105.
"Remedy". Section 4-1-201.
"Seller". Section 4-2-103.

ANNOTATION

Law reviews. For article, "Exclusion and Modification of Warranty under the U.C.C. — How to Succeed in Business Without Being Liable for Not Really Trying", see 46 Den. L.J. 579 (1969).

Issues of fact must be determined before the applicability of the doctrines of failure of essential purpose and unconscionability can be ruled upon. Wenner Petro. v. Mitsui & Co., 748 P.2d 356 (Colo. App. 1987).

Whether failure of essential purpose doctrine applies requires a two-tiered evaluation: (1) Identification of the essential purpose of the limited remedy; and (2) whether the remedy in fact failed to accomplish such purpose. Cooley v. Big Horn Harvestore Sys., 813 P.2d 736 (Colo. 1991).

A remedy fails of its essential purpose if it operates to deprive a party of the substantial value of the contract. Cooley v. Big Horn Harvestore Sys., 813 P.2d 736 (Colo. 1991); Curragh Queensland Mining v. Dresser Indus., 55 P.3d 235 (Colo. App. 2002).

When the seller cannot cure the defects by repeated attempts to repair, a limitation of remedy to repair fails of its essential purpose and the buyer is then free to revoke acceptance of the goods. Rose v. Colo. Factory Homes, 10 P.3d 680 (Colo. App. 2000).

Consequential damages are available as a remedy under subsection (2) where contract remedy of replacement or repair of defective parts failed of its essential purpose. Such damages are available despite fact that parties' contract contained a provision which excluded remedy of consequential damages resulting from liability. Cooley v. Big Horn Harvestore Sys., 813 P.2d 736 (Colo. 1991).

The parties to a contract may vary the provisions of the Uniform Commercial Code by agreement, and may provide for remedies in addition to or in substitution for those provided by the Uniform Commercial Code. Colo. Interstate Gas Co. v. Chemco, Inc., 854 P.2d 1232 (Colo. 1993).

Parties may enter into an agreement that the remedy of consequential damages shall not be available in the event the remedy of a suit for breach of a limited warranty to repair or replace fails of its essential purpose; however, such agreement must be expressly stated in clear and unambiguous language. Cooley v. Big Horn Harvestore Sys., 813 P.2d 736 (Colo. 1991).

When a purchase agreement establishing that the only warranty provided is a warranty to repair or replace defective parts contains no separate provision unambiguously recording the intent of parties to prohibit a buyer's recovery of consequential damages even when such sole remedy fails of its essential purpose, the buyer is entitled to the statutory remedy of consequential damages notwithstanding a general contractual disclaimer to the contrary. Cooley v. Big Horn Harvestore Sys., 813 P.2d 736 (Colo. 1991).

Applied in Leprino v. Intermountain Brick Co., 759 P.2d 835 (Colo. App. 1988).

4-2-720. Effect of "cancellation" or "rescission" on claims for antecedent breach. Unless the contrary intention clearly appears, expressions of "cancellation" or "rescission" of the contract or the like shall not be construed as a renunciation or discharge of any claim in damages for an antecedent breach.

Source: L. 65: p. 1342, § 1. **C.R.S. 1963:** § 155-2-720.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purpose:

This section is designed to safeguard a person holding a right of action from any unintentional loss of rights by the ill-advised use of such terms as "cancellation", "rescission", or the like. Once a party's rights have accrued they are not to be lightly impaired by concessions made in business decency and without intention to forego them. Therefore, unless the cancellation of a contract expressly declares that it is "without reservation of rights", or the like, it cannot be considered to be a renunciation under this section.

Cross Reference:

Section 4-1-107.

Definitional Cross References:

"Cancellation". Section 4-2-106.
"Contract". Section 4-1-201.

4-2-721. Remedies for fraud. Remedies for material misrepresentation or fraud include all remedies available under this article for nonfraudulent breach. Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy.

Source: L. 65: p. 1342, § 1. **C.R.S. 1963:** § 155-2-721.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes: To correct the situation by which remedies for fraud have been more circumscribed than the more modern and mercantile remedies for breach of warranty. Thus the remedies for fraud are extended by this section to coincide in scope with those for non-fraudulent breach. This section thus makes it clear that neither rescission of the contract for fraud nor rejection of the goods bars other remedies unless the circumstances of the case make the remedies incompatible.
Definitional Cross References:
"Contract for sale". Section 4-2-106.
"Goods". Section 4-1-201.
"Remedy". Section 4-1-201.

ANNOTATION

"Reason to know" formulation not exclusive remedy in fraud suits. The code does not require that the "reason to know" formulation be applied in fraud suits to the exclusion of other remedies; it only provides that the remedies available under the "reason to know" formulation are included among the remedies available to a defrauded purchaser. Wagner v. Dan Unfug Motors, Inc., 35 Colo. App. 102, 529 P.2d 656 (1974).

False representation of a material fact, even though innocently made, may merit rescission of a contract or revocation of acceptance. Keen v. Modern Trailer Sales, Inc., 40 Colo. App. 527, 578 P.2d 668 (1978).

Right to consequential damages. Since a party's right to consequential damages is presumably a "remedy" within the meaning of this section, application of the code to the question of the availability of damages for loss of use of a personal vehicle is warranted. Wagner v. Dan Unfug Motors, Inc., 35 Colo. App. 102, 529 P.2d 656 (1974).

Burden of proof. When fraud is pleaded, it is incumbent upon plaintiff to prove that defendant made the false representation with knowledge of its falsity or with utter disregard for its truth and falsity. Caldwell v. Kats, 38 Colo. App. 156, 555 P.2d 190 (1976), rev'd, 193 Colo. 384, 567 P.2d 371 (1977).

4-2-722. Who can sue third parties for injury to goods. Where a third party so deals with goods which have been identified to a contract for sale as to cause actionable injury to a party to that contract:

(a) A right of action against the third party is in either party to the contract for sale who has title to or a security interest or a special property or an insurable interest in the goods; and if the goods have been destroyed or converted, a right of action is also in the party who either bore the risk of loss under the contract for sale or has since the injury assumed that risk as against the other;

(b) If at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the contract for sale and there is no arrangement between them for disposition of the recovery, his suit or settlement is, subject to his own interest, as a fiduciary for the other party to the contract;

(c) Either party may with the consent of the other sue for the benefit of whom it may concern.

Source: L. 65: p. 1343, § 1. **C.R.S. 1963:** § 155-2-722.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes: To adopt and extend somewhat the principle of the statutes which provide for suit by the real party in interest. The provisions of this section apply only after identification of the goods. Prior to that time only the seller has a right of action. During the period between identification and final acceptance (except in the case of revocation of acceptance) it is possible for both parties to have the right of action. Even after final acceptance both parties may have the right of action if the seller retains possession or otherwise retains an interest.
Definitional Cross References:
"Action". Section 4-1-201.
"Buyer". Section 4-2-103.

"Contract for sale". Section 4-2-106.
"Goods". Section 4-2-105.
"Party". Section 4-1-201.
"Rights". Section 4-1-201.
"Security interest". Section 4-1-201.

4-2-723. Proof of market price - time and place. (1) If an action based on anticipatory repudiation comes to trial before the time for performance with respect to some or all of the goods, any damages based on market price (section 4-2-708 or section 4-2-713) shall be determined according to the price of such goods prevailing at the time when the aggrieved party learned of the repudiation.

(2) If evidence of a price prevailing at the times or places described in this article is not readily available, the price prevailing within any reasonable time before or after the time described or at any other place which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the cost of transporting the goods to or from such other place.

(3) Evidence of a relevant price prevailing at a time or place other than the one described in this article offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise.

Source: L. 65: p. 1343, § 1. **C.R.S. 1963:** § 155-2-723.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes: To eliminate the most obvious difficulties arising in connection with the determination of market price, when that is stipulated as a measure of damages by some provision of this Article. Where the appropriate market price is not readily available the court is here granted reasonable leeway in receiving evidence of prices current in other comparable markets or at other times comparable to the one in question. In accordance with the general principle of this Article against surprise, however, a party intending to offer evidence of such a substitute price must give suitable notice to the other party.

This section is not intended to exclude the use of any other reasonable method of determining market price or of measuring damages if the circumstances of the case make this necessary.

Definitional Cross References:
"Action". Section 4-1-201.
"Aggrieved party". Section 4-1-201.
"Goods". Section 4-2-105.
"Notifies". Section 4-1-201.
"Party". Section 4-1-201.
"Reasonable time". Section 4-1-204.
"Usage of trade". Section 4-1-205.

4-2-724. Admissibility of market quotations. Whenever the prevailing price or value of any goods regularly bought and sold in any established commodity market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of such market shall be admissible in evidence. The circumstances of the preparation of such a report may be shown to affect its weight but not its admissibility.

Source: L. 65: p. 1343, § 1. **C.R.S. 1963:** § 155-2-724.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.
Purposes: To make market quotations admissible in evidence while providing for a challenge of the material by showing the circumstances of its preparation.

No explicit provision as to the weight to be given to market quotations is contained in this section, but such quotations, in the absence of compelling challenge, offer an adequate basis for a verdict.

Market quotations are made admissible when the price or value of goods traded "in any established market" is in issue. The reason of the section does not require that the market be closely organized in the manner of a produce exchange. It is sufficient if transactions in the commodity are frequent and open enough to make a market established by usage in which one price can be expected to affect another and in which an informed report of the range and

trend of prices can be assumed to be reasonably accurate.

This section does not in any way intend to limit or negate the application of similar rules of admissibility to other material, whether by action of the courts or by statute. The purpose of the present section is to assure a minimum of mercantile administration in this important situation and not to limit any liberalizing trend in modern law.

Definitional Cross Reference:
"Goods". Section 4-2-105.

ANNOTATION

Law reviews. For article, "Hearsay in Criminal Cases Under The Colorado Rules of Evidence: An Overview", see 50 U. Colo. L. Rev. 277 (1979).

4-2-725. Statute of limitations in contracts for sale. (1) An action for breach of any contract for sale must be commenced within the time period prescribed in section 13-80-101, C.R.S. This period of limitation may not be varied by agreement of the parties.

(2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made; except, that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance, the cause of action accrues when the breach is or should have been discovered.

(3) Where an action commenced within the time limited by subsection (1) of this section is so terminated as to leave available a remedy by another action for the same breach, such other action may be commenced after the expiration of the time limited and within six months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action which have accrued before this title becomes effective.

Source: L. 65: p. 1344, § 1. **C.R.S. 1963:** § 155-2-725. **L. 86:** (1) amended, p. 702, § 5, effective July 1.

Editor's note - Colorado legislative change: In subsection (1), Colorado substituted the three-year statute of limitations in § 13-80-101 for the four-year statute of limitations in the uniform act. The official text also provided that the parties could reduce the period of limitation to a minimum of one year, but they could not extend the period. Colorado has provided that the period of limitation may not be reduced or extended.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: None.

Purposes: To introduce a uniform statute of limitations for sales contracts, thus eliminating the jurisdictional variations and providing needed relief for concerns doing business on a nationwide scale whose contracts have heretofore been governed by several different periods of limitation depending upon the state in which the transaction occurred. This Article takes sales contracts out of the general laws limiting the time for commencing contractual actions and selects a four year period as the most appropriate to modern business practice. This is within the normal commercial record keeping period.

Subsection (1) permits the parties to reduce the period of limitation. The minimum period is set at one year. The parties may not, however, extend the statutory period.

Subsection (2), providing that the cause of action accrues when the breach occurs, states an exception where the warranty extends to future performance.

Subsection (3) states the saving provision included in many state statutes and permits an additional short period for bringing new actions, where suits begun within the four year period have been terminated so as to leave a remedy still available for the same breach.

Subsection (4) makes it clear that this Article does not purport to alter or modify in any respect the law on tolling of the Statute of Limitations as it now prevails in the various jurisdictions.

Definitional Cross References:
"Action". Section 4-1-201.
"Aggrieved party". Section 4-1-201.
"Agreement". Section 4-1-201.
"Contract for sale". Section 4-2-106.

"Goods". Section 4-2-105.
"Party". Section 4-1-201.
"Remedy". Section 4-1-201.
"Term". Section 4-1-201.
"Termination". Section 4-2-106.

ANNOTATION

Subsection (1) prohibits shortening of limitation period. Avedon Eng'g, Inc. v. Seatex, 112 F. Supp.2d 1090 (D. Colo. 2000).

Whether arbitration is an "action" subject to limitation period does not control the outcome, if a unilateral term shortening limitation period to one year creates surprise and hardship. Avedon Eng'g, Inc. v. Seatex, 112 F. Supp.2d 1090 (D. Colo. 2000).

Running of statute of limitations for breach of express warranty. In an explicit warranty of a roof for five years the statute begins to run, not when the first leak is discovered, but when the party discovered or should have discovered that the roofer was unable or unwilling to maintain the roof as warranted. Smith v. Union Supply Co., 675 P.2d 333 (Colo. App. 1983).

Breach defined. When performance of a duty under a contract is due, any non-performance is a breach. D.O.M. Farms v. Nakamoto, 718 P.2d 262 (Colo. App. 1986).

Claims for breach of warranty governed by this section and not former § 13-80-127.5 since such claims are causes of action based upon contract. Ayala v. Joy Mfg. Co., 580 F. Supp. 521 (D. Colo. 1984).

Actions or claims for breach of express and implied warranties under the UCC are governed by this section and not former § 13-80-127.5. Wieser v. Firestone Tire & Rubber Co., 596 F. Supp. 1473 (D. Colo. 1984).

Persons not parties to the sale are still subject to the limitations period of this section. Wieser v. Firestone Tire & Rubber Co., 596 F. Supp. 1473 (D. Colo. 1984); Anderson v. Deere & Co., 622 F. Supp. 290 (D. Colo. 1985).

For the future performance exception of statute to apply, there must be a warranty that explicitly extends to future performance of the goods. Smith v. Union Supply Co., 675 P.2d 333 (Colo. App. 1983); Boyd v. A.O. Smith Harvestore Prods., 776 P.2d 1125 (Colo. App. 1989).

Warranty did not extend to future performance of goods and buyer's cause of action accrued when tender of delivery was made where manufacturer, by provisions of sale contract, did not explicitly promise that the product would not malfunction, only that, if it did, it would be repaired or replaced. Boyd v. A.O. Smith Harvestore Prods., 776 P.2d 1125 (Colo. App. 1989).

Actions of seller toll statute of limitations. Where a seller delivered a good, made repeated assurances that the product would be repaired to meet contract performance requirements and made efforts to improve the product, those promises and efforts tolled the statute of limitations in subsection (1) until the seller denied liability and refused to make further efforts to improve the product. Colorado-Ute Elec. Ass'n v. Envirotech Corp., 524 F. Supp. 1152 (D. Colo. 1981).

Where seller guaranteed buyer that product would perform at a certain level of reliability for successive intervals until a specified time, this guarantee effectively delayed commencement of the limitations period for seeking a "true fix" remedy until that time. Curragh Queensland Mining v. Dresser Indus., 55 P.3d 235 (Colo. App. 2002).

Because this section contains no specific tolling provision and does not otherwise indicate to the contrary, the general tolling provisions of § 13-81-103 apply. Haberkorn by Haberkorn v. ROHM-GMBH, 709 P.2d 44 (Colo. App. 1985).

Applied in Glen Peck, Ltd. v. Fritsche, 651 P.2d 414 (Colo. App. 1981); Hawkinson v. A.H. Robins, Co., Inc., 595 F. Supp. 1290 (D. Colo. 1984); Richard O'Brien Companies v. Challenge-Cook Bros., 672 F. Supp. 466 (D. Colo. 1987).

ARTICLE 2.5

Leases

Editor's note: (1) The National Conference of Commissioners on Uniform State Laws numbered this article as "2A". In C.R.S., it is numbered as article "2.5". References in the OFFICIAL COMMENTS to specific sections can be translated to C.R.S. numbers by changing "2A" to "2.5" and, where necessary, adding the appropriate title of C.R.S. For example, a reference in an OFFICIAL COMMENT to section "2A-101" would translate to section "4-2.5-101".

(2) The numbering and sequencing of C.R.S. subsections do not necessarily correspond with the numbering and sequencing of subsections in the uniform act.

PART 1

GENERAL PROVISIONS

PART 2

FORMATION AND CONSTRUCTION OF LEASE CONTRACT

PART 3

EFFECT OF LEASE CONTRACT

PART 4

PERFORMANCE OF LEASE CONTRACT: REPUDIATED, SUBSTITUTED AND EXCUSED

PART 5

DEFAULT

A. In General

PART 1

GENERAL PROVISIONS

4-2.5-101. Short title. This article shall be known and may be cited as the "Uniform Commercial Code - Leases".

Source: L. 91: Entire article added, p. 272, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Rationale for Codification:

There are several reasons for codifying the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least three significant issues to be resolved by codification. First, what is a lease? It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases. Yet the distinction between a lease and a security interest disguised as a lease is not clear. Second, will the lessor be deemed to have made warranties to the lessee? If the transaction is a sale the express and implied warranties of Article 2 of the Uniform Commercial Code apply. However, the warranty law with respect to leases is uncertain. Third, what remedies are available to the lessor upon the lessee's default? If the transaction is a security interest disguised as a lease, the answer is stated in Part 5 of the Article on Secured Transactions (Article 9). There is no clear answer with respect to leases.

There are reasons to codify the law with respect to leases of goods in addition to those suggested by a review of the reported cases. The answer to this important question should not be limited to the issues raised in these cases. Is it not also proper to determine the remedies available to the lessee upon the lessor's default? It is, but that issue is not reached through a review of the reported cases. This is only one of the many issues presented in structuring, negotiating and documenting a lease of goods.

Statutory Analogue:

After it was decided to proceed with the codification project, the drafting committee of the National Conference of Commissioners on Uniform State Laws looked for a statutory analogue, gradually narrowing the focus to the Article on Sales (Article 2) and the Article on Secured Transactions (Article 9). A review of the literature with respect to the sale of goods reveals that Article 2 is predicated upon certain assumptions: Parties to the sales transaction frequently are without counsel; the agreement of the parties often is oral or evidenced by scant writings; obligations between the parties are bilateral; applicable law is influenced by the need to preserve freedom of contract. A review of the literature with respect to personal property security law reveals that Article 9 is predicated upon very different assumptions: Parties to a secured transaction regularly are represented by counsel; the agreement of the parties frequently is reduced to a writing, extensive in scope; the obligations between the parties are essentially unilateral; and applicable law seriously limits freedom of contract.

The lease is closer in spirit and form to the sale of goods than to the creation of a security interest. While parties to a lease are sometimes represented by counsel and their agreement is often reduced to a writing, the obligations of the parties are bilateral and the common law of leasing is dominated by the need to preserve freedom of contract. Thus the drafting committee concluded that Article 2 was the appropriate statutory analogue.

Issues: The drafting committee then identified and resolved several issues critical to codification:

Scope: The scope of the Article was limited to leases (Section 2A-102). There was no need to include leases intended as security, i.e., security interests disguised as leases, as they are adequately treated in Article 9. Further, even if leases intended as security were included, the need to preserve the distinction would remain, as policy suggests treatment significantly different from that accorded leases.

Definition of Lease: Lease was defined to exclude leases intended as security (Section 2A-103(1)(j)). Given the litigation to date a revised definition of security interest was suggested for inclusion in the Act. (Section 1-201(37)). This revision sharpens the distinction between leases and security interests disguised as leases.

Filing: The lessor was not required to file a financing statement against the lessee or take any other action to protect the lessor's interest in the goods (Section 2A-301). The refined definition of security interest will more clearly signal the need to file to potential lessors of goods. Those lessors who are concerned will file a protective financing statement (Section 9-408).

Warranties: All of the express and implied warranties of the Article on Sales (Article 2) were included (Sections 2A-210 through 2A-216), revised to reflect differences in lease transactions. The lease of goods is sufficiently similar to the sale of goods to justify this decision. Further, many courts have reached the same decision.

Certificate of Title Laws: Many leasing transactions involve goods subject to certificate of title statutes. To avoid conflict with those statutes, this Article is subject to them (Section 2A-104(1)(a)).

Consumer Leases: Many leasing transactions involve parties subject to consumer protection statutes or decisions. To avoid conflict with those laws this Article is subject to them to the extent provided in Section 2A-104(1)(c) and (2). Further, certain consumer protections have been incorporated in the Article.

Finance Leases: Certain leasing transactions substitute the supplier of the goods for the lessor as the party responsible to the lessee with respect to warranties and the like. The definition of finance lease (Section 2A-103(1)(g)) was developed to describe these transactions. Various sections of the Article implement the substitution of the supplier for the lessor, including Sections 2A-209 and 2A-407. No attempt was made to fashion a special rule where the finance lessor is an affiliate of the supplier of goods; this is to be developed by the courts, case by case.

Sale and Leaseback: Sale and leaseback transactions are becoming increasingly common. A number of state statutes treat transactions where possession is retained by the seller as fraudulent per se or prima facie fraudulent. That position is not in accord with modern practice and thus is changed by the Article "if the buyer bought for value and in good faith" (Section 2A-308(3)).

Remedies: The Article has not only provided for lessor's remedies upon default by the lessee (Sections 2A-523 through 2A-531), but also for lessee's remedies upon default by the lessor (Sections 2A-508 through 2A-522). This is a significant departure from Article 9, which provides remedies only for the secured party upon default by the debtor. This difference is compelled by the bilateral nature of the obligations between the parties to a lease.

Damages: Many leasing transactions are predicated on the parties' ability to stipulate an appropriate measure of damages in the event of default. The rule with respect to sales of goods (Section 2-718) is not sufficiently flexible to accommodate this practice. Consistent with the common law emphasis upon freedom to contract, the Article has created a revised rule that allows greater flexibility with respect to leases of goods (Section 2A-504(1)).

History:

This Article is a revision of the Uniform Personal Property Leasing Act, which was ap-

proved by the National Conference of Commissioners on Uniform State Laws in August, 1985. However, it was believed that the subject matter of the Uniform Personal Property Leasing Act would be better treated as an article of this Act. Thus, although the Conference promulgated the Uniform Personal Property Leasing Act as a Uniform Law, activity was held in abeyance to allow time to restate the Uniform Personal Property Leasing Act as Article 2A.

In August, 1986 the Conference approved and recommended this Article (including conforming amendments to Article 1 and Article 9) for promulgation as an amendment to this Act. In December, 1986 the Council of the American Law Institute approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In March, 1987 the Permanent Editorial Board for the Uniform Commercial Code approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In May, 1987 the American Law Institute approved and recommended this Article (including conforming amendments to Article 1 and Article 9), with official comments, for promulgation as an amendment to this Act. In August, 1987 the Conference confirmed its approval of the final text of this Article.

Upon its initial promulgation, Article 2A was rapidly enacted in several states, was introduced in a number of other states, and underwent bar association, law revision commission and legislative study in still further states. In that process debate emerged, principally sparked by the study of Article 2A by the California Bar Association, California's non-uniform amendments to Article 2A, and articles appearing in a symposium on Article 2A published after its promulgation in the Alabama Law Review. The debate chiefly centered on whether Article 2A had struck the proper balance or was clear enough concerning the ability of a lessor to grant a security interest in its leasehold interest and in the residual, priority between a secured party and the lessee, and the lessor's remedy structure under Article 2A.

This debate over issues on which reasonable minds could and did differ began to affect the enactment effort for Article 2A in a deleterious manner. Consequently, the Standby Committee for Article 2A, composed predominantly of the former members of the drafting committee, reviewed the legislative actions and studies in the various states, and opened a dialogue with the principal proponents of the non-uniform amendments. Negotiations were conducted in conjunction with, and were facilitated by, a study of the uniform Article and the non-uniform Amendments by the New York Law Revision Commission. Ultimately, a consensus was reached, which has been approved by the membership of the Conference, the Permanent Editorial Board, and the Council of the Institute. Rapid and uniform enactment of Article 2A is expected as a result of the completed amendments. The Article 2A experience reaffirms the essential viability of the procedures of the Conference and the Institute for creating and updating uniform state law in the commercial law area.

Relationship of Article 2A to Other Articles:

The Article on Sales provided a useful point of reference for codifying the law of leases. Many of the provisions of that Article were carried over, changed to reflect differences in style, leasing terminology or leasing practices. Thus, the official comments to those sections of Article 2 whose provisions were carried over are incorporated by reference in Article 2A, as well; further, any case law interpreting those provisions should be viewed as persuasive but not binding on a court when deciding a similar issue with respect to leases. Any change in the sequence that has been made when carrying over a provision from Article 2 should be viewed as a matter of style, not substance. This is not to suggest that in other instances Article 2A did not also incorporate substantially revised provisions of Article 2, Article 9 or otherwise where the revision was driven by a concern over the substance; but for the lack of a mandate, the drafting committee might well have made the same or a similar change in the statutory analogue. Those sections in Article 2A include Sections 2A-104, 2A-105, 2A-106, 2A-108(2) and (4), 2A-109(2), 2A-208, 2A-214(2) and (3)(a), 2A-216, 2A-303, 2A-306, 2A-503, 2A-504(3)(b), 2A-506(2), and 2A-515. For lack of relevance or significance not all of the provisions of Article 2 were incorporated in Article 2A.

This codification was greatly influenced by the fundamental tenet of the common law as it has developed with respect to leases of goods: freedom of the parties to contract. Note that, like all other Articles of this Act, the principles of construction and interpretation contained in Article 1 are applicable throughout Article 2A (Section 2A-103(4)). These principles include the ability of the parties to vary the effect of the provisions of Article 2A, subject to certain limitations including those that relate to the obligations of good faith, diligence, reasonableness and care (Section 1-102(3)). Consistent with those principles no negative inference is to be drawn by the episodic use of the phrase "unless otherwise agreed" in certain provisions of Article 2A. Section 1-102(4). Indeed, the contrary is true, as the general rule in the Act, including this Article, is that the effect of the Act's provisions may be varied by agreement. Section 1-102(3). This conclusion follows even where the statutory analogue contains the phrase and the correlative provision in Article 2A does not.

ANNOTATION

Law reviews. For article, "Personal Property Leases and the New UCC Article 2.5", see 21 Colo Law. 1101 (1992).

4-2.5-102. Scope. This article applies to any transaction, regardless of form, that creates a lease.

Source: L. 91: Entire article added, p. 272, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-102(1). Throughout this Article, unless otherwise stated, references to "Section" are to other sections of this Act.
Changes: Substantially revised.
Purposes:
This Article governs transactions as diverse as the lease of a hand tool to an individual for a few hours and the leveraged lease of a complex line of industrial equipment to a multi-national organization for a number of years.

To achieve that end it was necessary to provide that this Article applies to any transaction, regardless of form, that creates a lease. Since lease is defined as a transfer of an interest in goods (Section 2A-103(1)(j)) and goods is defined to include fixtures (Section 2A-103(1)(h)), application is limited to the extent the transaction relates to goods, including fixtures. Further, since the definition of lease does not include a sale (Section 2-106(1)) or retention or creation of a security interest (Section 1-201(37)), application is further limited; sales and security interests are governed by other Articles of this Act.

Finally, in recognition of the diversity of the transactions to be governed, the sophistication of many of the parties to these transactions, and the common law tradition as it applies to the bailment for hire or lease, freedom of contract has been preserved. DeKoven, Proceedings After Default by the Lessee Under a True Lease of Equipment, in 1C P. Coogan, W. Hogan, D. Vagts, Secured Transactions Under the Uniform Commercial Code, § 29B.02[2] (1986). Thus, despite the extensive regulatory scheme established by this Article, the parties to a lease will be able to create private rules to govern their transaction. Sections 2A-103(4) and 1-102(3). However, there are special rules in this Article governing consumer leases, as well as other state and federal statutes, that may further limit freedom of contract with respect to consumer leases.

A court may apply this Article by analogy to any transaction, regardless of form, that creates a lease of personal property other than goods, taking into account the expressed intentions of the parties to the transaction and any differences between a lease of goods and a lease of other property. Such application has precedent as the provisions of the Article on Sales (Article 2) have been applied by analogy to leases of goods. E.g., Hawkland, The Impact of the Uniform Commercial Code on Equipment Leasing, 1972 Ill. L.F. 446; Murray, Under the Spreading Analogy of Article 2 of the Uniform Commercial Code, 39 Fordham L. Rev. 447 (1971). Whether such application would be appropriate for other bailments of personal property, gratuitous or for hire, should be determined by the facts of each case. See Mieske v. Bartell Drug Co., 92 Wash. 2d 40, 46-48, 593 P.2d 1308, 1312 (1979).

Further, parties to a transaction creating a lease of personal property other than goods, or a bailment of personal property may provide by agreement that this Article applies. Upholding the parties' choice is consistent with the spirit of this Article.

Cross References:
Sections 1-102(3), 1-201(37), Article 2, esp. Section 2-106(1), and Sections 2A-103(1)(h), 2A-103(1)(j) and 2A-103(4).

Definitional Cross Reference:
"Lease". Section 2A-103(1)(j).

4-2.5-103. Definitions and index of definitions. (1) In this article unless the context otherwise requires:

(a) "Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him or her is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods, buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes acquiring goods or documents of title under a preexisting

contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(b) "Cancellation" occurs when either party puts an end to the lease contract for default by the other party.

(c) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of lease and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article, as a machine, or a set of articles, as a suite of furniture or a line of machinery, or a quantity, as a gross or carload, or any other unit treated in use or in the relevant market as a single whole.

(d) "Conforming" goods or performance under a lease contract means goods or performance that are in accordance with the obligations under the lease contract.

(e) "Consumer lease" means a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee who is an individual and who takes under the lease primarily for a personal, family, or household purpose, if the total payments to be made under the lease contract, excluding payments for options to renew or buy, do not exceed twenty-five thousand dollars.

(f) "Fault" means wrongful act, omission, breach, or default.

(g) "Finance lease" means a lease with respect to which:

(i) The lessor does not select, manufacture or supply the goods;

(ii) The lessor acquires the goods or the right to possession and use of the goods in connection with the lease; and

(iii) One of the following occurs:

(A) The lessee receives a copy of the contract by which the lessor acquired the goods or the right to possession and use of the goods before signing the lease contract;

(B) The lessee's approval of the contract by which the lessor acquired the goods or the right to possession and use of the goods is a condition to effectiveness of the lease contract;

(C) The lessee, before signing the lease contract, receives an accurate and complete statement designating the promises and warranties, and any disclaimers of warranties, limitations or modifications of remedies, of liquidated damages, including those of a third party, such as the manufacturer of the goods, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods; or

(D) If the lease is not a consumer lease, the lessor, before the lessee signs the lease contract, informs the lessee in writing (a) of the identity of the person supplying the goods to the lessor, unless the lessee has selected that person and directed the lessor to acquire the goods or the right to possession and use of the goods from that person, (b) that the lessee is entitled under this article to the promises and warranties, including those of any third party, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods, and (c) that the lessee may communicate with the person supplying the goods to the lessor and receive an accurate and complete statement of those promises and warranties, including any disclaimers and limitations of them or of remedies.

(h) "Goods" means all things that are movable at the time of identification to the lease contract, or are fixtures (section 4-2.5-309), but the term does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like, including oil and gas, before extraction. The term also includes the unborn young of animals.

(i) "Installment lease contract" means a lease contract that authorizes or requires the delivery of goods in separate lots to be separately accepted, even though the lease contract contains a clause "each delivery is a separate lease" or its equivalent.

(j) "Lease" means a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease. Unless the context clearly indicates otherwise, the term includes a sublease.

(k) "Lease agreement" means the bargain, with respect to the lease, of the lessor and the lessee in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this

article. Unless the context clearly indicates otherwise, the term includes a sublease agreement.

(l) "Lease contract" means the total legal obligation that results from the lease agreement as affected by this article and any other applicable rules of law. Unless the context clearly indicates otherwise, the term includes a sublease contract.

(m) "Leasehold interest" means the interest of the lessor or the lessee under a lease contract.

(n) "Lessee" means a person who acquires the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessee.

(o) "Lessee in ordinary course of business" means a person who in good faith and without knowledge that the lease to him or her is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods leases in ordinary course from a person in the business of selling or leasing goods of that kind but does not include a pawnbroker. "Leasing" may be for cash or by exchange of other property or on secured or unsecured credit and includes acquiring goods or documents of title under a preexisting lease contract but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(p) "Lessor" means a person who transfers the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessor.

(q) "Lessor's residual interest" means the lessor's interest in the goods after expiration, termination, or cancellation of the lease contract.

(r) "Lien" means a charge against or interest in goods to secure payment of a debt or performance of an obligation, but the term does not include a security interest.

(s) "Lot" means a parcel or a single article that is the subject matter of a separate lease or delivery, whether or not it is sufficient to perform the lease contract.

(t) "Merchant lessee" means a lessee that is a merchant with respect to goods of the kind subject to the lease.

(u) "Present value" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate was not manifestly unreasonable at the time the transaction was entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

(v) "Purchase" includes taking by sale, lease, mortgage, security interest, pledge, gift, or any other voluntary transaction creating an interest in goods.

(w) "Sublease" means a lease of goods the right to possession and use of which was acquired by the lessor as a lessee under an existing lease.

(x) "Supplier" means a person from whom a lessor buys or leases goods to be leased under a finance lease.

(y) "Supply contract" means a contract under which a lessor buys or leases goods to be leased.

(z) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the lease contract otherwise than for default.

(2) Other definitions applying to this article and the sections in which they appear are:

"Accessions".	Section 4-2.5-310 (1).
"Construction mortgage".	Section 4-2.5-309 (1) (d).
"Encumbrance".	Section 4-2.5-309 (1) (e).
"Fixtures".	Section 4-2.5-309 (1) (a).
"Fixture filing".	Section 4-2.5-309 (1) (b).
"Purchase money lease".	Section 4-2.5-309 (1) (c).

(3) The following definitions in other articles apply to this article:

"Account".	Section 4-9-102 (a) (2).
"Between merchants".	Section 4-2-104 (3).
"Buyer".	Section 4-2-103 (1) (a).
"Chattel paper".	Section 4-9-102 (a) (11).
"Consumer goods".	Section 4-9-102 (a) (23).
"Document".	Section 4-9-102 (a) (30).

"Entrusting".	Section 4-2-403 (3).
"General intangible".	Section 4-9-102 (a) (42).
"Good faith".	Section 4-2-103 (1) (b).
"Instrument".	Section 4-9-102 (a) (47).
"Merchant".	Section 4-2-104 (1).
"Mortgage".	Section 4-9-102 (a) (55).
"Pursuant to commitment".	Section 4-9-102 (a) (71).
"Receipt".	Section 4-2-103 (1) (c).
"Sale".	Section 4-2-106 (1).
"Sale on approval".	Section 4-2-326.
"Sale or return".	Section 4-2-326.
"Seller".	Section 4-2-103 (1) (d).

(4) In addition, article 1 of this title contains general definitions and principles of construction and interpretation applicable throughout this article.

Source: L. 91: Entire article added, p. 272, § 1, effective July 1, 1992. **L. 2001:** (3) amended, p. 1438, § 23, effective July 1. **L. 2002:** (3) amended, p. 1011, § 1, effective June 1. **L. 2006:** (1)(a) and (1)(o) amended, p. 493, § 16, effective September 1.

Editor's note - Colorado legislative change: Colorado inserted the amount of "twenty-five thousand dollars" in the definition of "consumer lease" in paragraph (e) of subsection (1) of this section.

OFFICIAL COMMENT

(a) "Buyer in ordinary course of business". Section 1-201(9).

(b) "Cancellation". Section 2-106(4). The effect of a cancellation is provided in Section 2A-505(1).

(c) "Commercial unit". Section 2-105(6).

(d) "Conforming". Section 2-106(2).

(e) "Consumer lease". New. This Article includes a subset of rules that applies only to consumer leases. Sections 2A-106, 2A-108(2), 2A-108(4), 2A-109(2), 2A-221, 2A-309, 2A-406, 2A-407, 2A-504(3)(b), and 2A-516(3)(b).

For a transaction to qualify as a consumer lease it must first qualify as a lease. Section 2A-103(1)(j). Note that this Article regulates the transactional elements of a lease, including a consumer lease; consumer protection statutes -, present and future -, and existing consumer protection decisions are unaffected by this Article. Section 2A-104(1)(c) and (2). Of course, Article 2A as state law also is subject to federal consumer protection law.

This definition is modeled after the definition of consumer lease in the Consumer Leasing Act, 15 U.S.C. § 1667 (1982), and in the Unif. Consumer Credit Code § 1.301(14), 7A U.L.A. 43 (1974). However, this definition of consumer lease differs from its models in several respects: the lessor can be a person regularly engaged either in the business of leasing or of selling goods, the lease need not be for a term exceeding four months, a lease primarily for an agricultural purpose is not covered, and whether there should be a limitation by dollar amount and its amount is left up to the individual states.

This definition focuses on the parties as well as the transaction. If a lease is within this definition, the lessor must be regularly engaged in the business of leasing or selling, and the lessee must be an individual not an organization; note that a lease to two or more individuals having a common interest through marriage or the like is not excluded as a lease to an organization under Section 1-201(28). The lessee must take the interest primarily for a personal, family or household purpose. If required by the enacting state, total payments under the lease contract, excluding payments for options to renew or buy, cannot exceed the figure designated.

(f) "Fault". Section 1-201(16).

(g) "Finance Lease". New. This Article includes a subset of rules that applies only to finance leases. Sections 2A-209, 2A-211(2), 2A-212(1), 2A-213, 2A-219(1), 2A-220(1)(a), 2A-221, 2A-405(c), 2A-407, 2A-516(2) and 2A-517(1)(a) and (2).

For a transaction to qualify as a finance lease it must first qualify as a lease. Section 2A-103(1)(j). Unless the lessor is comfortable that the transaction will qualify as a finance lease, the lease agreement should include provisions giving the lessor the benefits created by the subset of rules applicable to the transaction that qualifies as a finance lease under this Article.

A finance lease is the product of a three party transaction. The supplier manufactures or supplies the goods pursuant to the lessee's specification, perhaps even pursuant to a purchase order, sales agreement or lease agreement between the supplier and the lessee. After the

prospective finance lease is negotiated, a purchase order, sales agreement, or lease agreement is entered into by the lessor (as buyer or prime lessee) or an existing order, agreement or lease is assigned by the lessee to the lessor, and the lessor and the lessee then enter into a lease or sublease of the goods. Due to the limited function usually performed by the lessor, the lessee looks almost entirely to the supplier for representations, covenants and warranties. If a manufacturer's warranty carries through, the lessee may also look to that. Yet, this definition does not restrict the lessor's function solely to the supply of funds; if the lessor undertakes or performs other functions, express warranties, covenants and the common law will protect the lessee.

This definition focuses on the transaction, not the status of the parties; to avoid confusion it is important to note that in other contexts, e.g., tax and accounting, the term finance lease has been used to connote different types of lease transactions, including leases that are disguised secured transactions. M. Rice, Equipment Financing, 62-71 (1981). A lessor who is a merchant with respect to goods of the kind subject to the lease may be a lessor under a finance lease. Many leases that are leases back to the seller of goods (Section 2A-308(3)) will be finance leases. This conclusion is easily demonstrated by a hypothetical. Assume that B has bought goods from C pursuant to a sales contract. After delivery to and acceptance of the goods by B, B negotiates to sell the goods to A and simultaneously to lease the goods back from A, on terms and conditions that, we assume, will qualify the transaction as a lease. Section 2A-103(1)(j). In documenting the sale and lease back, B assigns the original sales contract between B, as buyer, and C, as seller, to A. A review of these facts leads to the conclusion that the lease from A to B qualifies as a finance lease, as all three conditions of the definition are satisfied. Subparagraph (i) is satisfied as A, the lessor, had nothing to do with the selection, manufacture, or supply of the equipment. Subparagraph (ii) is satisfied as A, the lessor, bought the equipment at the same time that A leased the equipment to B, which certainly is in connection with the lease. Finally, subparagraph (iii) (A) is satisfied as A entered into the sales contract with B at the same time that A leased the equipment back to B. B, the lessee, will have received a copy of the sales contract in a timely fashion.

Subsection (i) requires the lessor to remain outside the selection, manufacture and supply of the goods; that is the rationale for releasing the lessor from most of its traditional liability. The lessor is not prohibited from possession, maintenance or operation of the goods, as policy does not require such prohibition. To insure the lessee's reliance on the supplier, and not on the lessor, subsection (ii) requires that the goods (where the lessor is the buyer of the goods) or that the right to possession and use of the goods (where the lessor is the prime lessee and the sublessor of the goods) be acquired in connection with the lease (or sublease) to qualify as a finance lease. The scope of the phrase "in connection with" is to be developed by the courts, case by case. Finally, as the lessee generally relies almost entirely upon the supplier for representations and covenants, and upon the supplier or a manufacturer, or both, for warranties with respect to the goods, subsection (iii) requires that one of the following occur: (A) the lessee receive a copy of the supply contract before signing the lease contract; (B) the lessee's approval of the supply contract is a condition to the effectiveness of the lease contract; (C) the lessee receive a statement describing the promises and warranties and any limitations relevant to the lessee before signing the lease contract; or (D) before signing the lease contract and except in a consumer lease, the lessee receive a writing identifying the supplier (unless the supplier was selected and required by the lessee) and the rights of the lessee under Section 2A-209, and advising the lessee a statement of promises and warranties is available from the supplier. Thus, even where oral supply orders or computer placed supply orders are compelled by custom and usage the transaction may still qualify as a finance lease if the lessee approves the supply contract before the lease contract is effective and such approval was a condition to the effectiveness of the lease contract. Moreover, where the lessor does not want the lessee to see the entire supply contract, including price information, the lessee may be provided with a separate statement of the terms of the supply contract relevant to the lessee; promises between the supplier and the lessor that do not affect the lessee need not be included. The statement can be a restatement of those terms or a copy of portions of the supply contract with the relevant terms clearly designated. Any implied warranties need not be designated, but a disclaimer or modification of remedy must be designated. A copy of any manufacturer's warranty is sufficient if that is the warranty provided. However, a copy of any Regulation M disclosure given pursuant to 12 C.F.R. § 213.4(g) concerning warranties in itself is not sufficient since those disclosures need only briefly identify express warranties and need not include any disclaimer of warranty.

If a transaction does not qualify as a finance lease, the parties may achieve the same result by agreement; no negative implications are to be drawn if the transaction does not qualify. Further, absent the application of special rules (fraud, duress, and the like), a lease that qualifies as a finance lease and is assigned by the lessor or the lessee to a third party does not lose its status as a finance lease under this Article. Finally, this

Article creates no special rule where the lessor is an affiliate of the supplier; whether the transaction qualifies as a finance lease will be determined by the facts of each case.

(h) "Goods". Section 9-105(1)(h). See Section 2A-103(3) for reference to the definition of "Account", "Chattel paper", "Document", "General intangibles" and "Instrument". See Section 2A-217 for determination of the time and manner of identification.

(i) "Installment lease contract". Section 2-612(1).

(j) "Lease". New. There are several reasons to codify the law with respect to leases of goods. An analysis of the case law as it applies to leases of goods suggests at least several significant issues to be resolved by codification. First and foremost is the definition of a lease. It is necessary to define lease to determine whether a transaction creates a lease or a security interest disguised as a lease. If the transaction creates a security interest disguised as a lease, the transaction will be governed by the Article on Secured Transactions (Article 9) and the lessor will be required to file a financing statement or take other action to perfect its interest in the goods against third parties. There is no such requirement with respect to leases under the common law and, except with respect to leases of fixtures (Section 2A-309), this Article imposes no such requirement. Yet the distinction between a lease and a security interest disguised as a lease is not clear from the case law at the time of the promulgation of this Article. DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.S.F. L. Rev. 257 (1978).

At common law a lease of personal property is a bailment for hire. While there are several definitions of bailment for hire, all require a thing to be let and a price for the letting. Thus, in modern terms and as provided in this definition, a lease is created when the lessee agrees to furnish consideration for the right to the possession and use of goods over a specified period of time. Mooney, Personal Property Leasing: A Challenge, 36 Bus. Law. 1605, 1607 (1981). Further, a lease is neither a sale (Section 2-106(1)) nor a retention or creation of a security interest (Section 1- 201(37)). Due to extensive litigation to distinguish true leases from security interests, an amendment to Section 1-201(37) has been promulgated with this Article to create a sharper distinction.

This section as well as Section 1-201(37) must be examined to determine whether the transaction in question creates a lease or a security interest. The following hypotheticals indicate the perimeters of the issue. Assume that A has purchased a number of copying machines, new, for $1,000 each; the machines have an estimated useful economic life of three years. A advertises that the machines are available to rent for a minimum of one month and that the monthly rental is $100.00. A intends to enter into leases where A provides all maintenance, without charge to the lessee. Further, the lessee will rent the machine, month to month, with no obligation to renew. At the end of the lease term the lessee will be obligated to return the machine to A's place of business. This transaction qualifies as a lease under the first half of the definition, for the transaction includes a transfer by A to a prospective lessee of possession and use of the machine for a stated term, month to month. The machines are goods (Section 2A-103(1)(h)). The lessee is obligated to pay consideration in return, $100.00 for each month of the term.

However, the second half of the definition provides that a sale or a security interest is not a lease. Since there is no passing of title, there is no sale. Sections 2A-103(3) and 2-106(1). Under pre-Act security law this transaction would have created a bailment for hire or a true lease and not a conditional sale. Da Rocha v. Macomber, 330 Mass. 611, 614-15, 116 N.E.2d 139, 142 (1953). Under Section 1-201(37), as amended with the promulgation of this Article, the same result would follow. While the lessee is obligated to pay rent for the one month term of the lease, one of the other four conditions of the second paragraph of Section 1-201(37) must be met and none is. The term of the lease is one month and the economic life of the machine is 36 months; thus, subparagraph (a) of Section 1-201(37) is not now satisfied. Considering the amount of the monthly rent, absent economic duress or coercion, the lessee is not bound either to renew the lease for the remaining economic life of the goods or to become the owner. If the lessee did lease the machine for 36 months, the lessee would have paid the lessor $3,600 for a machine that could have been purchased for $1,000; thus, subparagraph (b) of Section 1-201(37) is not satisfied. Finally, there are no options; thus, subparagraphs (c) and (d) of Section 1-201(37) are not satisfied. This transaction creates a lease, not a security interest. However, with each renewal of the lease the facts and circumstances at the time of each renewal must be examined to determine if that conclusion remains accurate, as it is possible that a transaction that first creates a lease, later creates a security interest.

Assume that the facts are changed and that A requires each lessee to lease the goods for 36 months, with no right to terminate. Under pre-Act security law this transaction would have created a conditional sale, and not a bailment for hire or true lease. Hervey v. Rhode Island Locomotive Works, 93 U.S. 664, 672-73 (1876). Under this subsection, and Section 1-201(37), as amended with the inclusion of this Article in the Act, the same result would follow. The lessee's obligation for the term is not subject to termi-

nation by the lessee and the term is equal to the economic life of the machine.

Between these extremes there are many transactions that can be created. Some of the transactions have not been properly categorized by the courts in applying the 1978 and earlier Official Texts of Section 1-201(37). This subsection, together with Section 1-201(37), as amended with the promulgation of this Article, draws a brighter line, which should create a clearer signal to the professional lessor and lessee.

(k) "Lease agreement". This definition is derived from the first sentence of Section 1-201(3). Because the definition of lease is broad enough to cover future transfers, lease agreement includes an agreement contemplating a current or subsequent transfer. Thus it was not necessary to make an express reference to an agreement for the future lease of goods (Section 2-106(1)). This concept is also incorporated in the definition of lease contract. Note that the definition of lease does not include transactions in ordinary building materials that are incorporated into an improvement on land. Section 2A-309(2).

The provisions of this Article, if applicable, determine whether a lease agreement has legal consequences; otherwise the law of bailments and other applicable law determine the same. Sections 2A-103(4) and 1-103.

(l) "Lease contract". This definition is derived from the definition of contract in Section 1-201(11). Note that a lease contract may be for the future lease of goods, since this notion is included in the definition of lease.

(m) "Leasehold interest". New.

(n) "Lessee". New.

(o) "Lessee in ordinary course of business". Section 1-201(9).

(p) "Lessor". New.

(q) "Lessor's residual interest". New.

(r) "Lien". New. This term is used in Section 2A-307 (Priority of Liens Arising by Attachment or Levy on, Security Interests in, and Other Claims to Goods).

(s) "Lot". Section 2-105(5).

(t) "Merchant lessee". New. This term is used in Section 2A-511 (Merchant Lessee's Duties as to Rightfully Rejected Goods). A person may satisfy the requirement of dealing in goods of the kind subject to the lease as lessor, lessee, seller, or buyer.

(u) "Present value". New. Authorities agree that present value should be used to determine fairly the damages payable by the lessor or the lessee on default. E.g., Taylor v. Commercial Credit Equip. Corp., 170 Ga. App. 322, 316 S.E.2d 788 (Ct. App. 1984). Present value is defined to mean an amount that represents the discounted value as of a date certain of one or more sums payable in the future. This is a function of the economic principle that a dollar today is more valuable to the holder than a dollar payable in two years. While there is no question as to the principle, reasonable people would differ as to the rate of discount to apply in determining the value of that future dollar today. To minimize litigation, this Article allows the parties to specify the discount or interest rate, if the rate was not manifestly unreasonable at the time the transaction was entered into. In all other cases, the interest rate will be a commercially reasonable rate that takes into account the facts and circumstances of each case, as of the time the transaction was entered into.

(v) "Purchase". Section 1-201(32). This definition omits the reference to lien contained in the definition of purchase in Article 1 (Section 1-201(32)). This should not be construed to exclude consensual liens from the definition of purchase in this Article; the exclusion was mandated by the scope of the definition of lien in Section 2A-103(1)(r). Further, the definition of purchaser in this Article adds a reference to lease; as purchase is defined in Section 1-201(32) to include any other voluntary transaction creating an interest in property, this addition is not substantive.

(w) "Sublease". New.

(x) "Supplier". New.

(y) "Supply contract". New.

(z) "Termination". Section 2-106(3). The effect of a termination is provided in Section 2A-505(2).

4-2.5-104. Leases subject to other law. (1) A lease, although subject to this article, is also subject to any applicable:

(a) Certificate of title statute of this state (including vessels under article 13 of title 33, C.R.S., snowmobiles under article 14 of title 33, C.R.S., mobile homes under article 29 of title 38, C.R.S., aircraft under article 2 of title 41, C.R.S., and motor vehicles under article 6 or 12 of title 42, C.R.S.);

(b) Certificate of title statute of another jurisdiction (section 4-2.5-105); or

(c) Consumer protection statute of this state, or final consumer protection decision of a court of this state existing on July 1, 1991.

(2) In case of conflict between this article, other than sections 4-2.5-105, 4-2.5-304 (3) and 4-2.5-305 (3), and a statute or decision referred to in subsection (1) of this section, the statute or decision controls.

(3) Failure to comply with an applicable law has only the effect specified therein.

Source: L. 91: Entire article added, p. 277, § 1, effective July 1, 1992. **L. 2011:** (1)(a) amended, (SB 11-031), ch. 86, p. 242, § 2, effective August 10.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 9-203(4) and 9-302(3)(b) and (c).
Changes: Substantially revised.
Purposes:

1. This Article creates a comprehensive scheme for the regulation of transactions that create leases. Section 2A-102. Thus, the Article supersedes all prior legislation dealing with leases, except to the extent set forth in this Section.

2. Subsection (1) states the general rule that a lease, although governed by the scheme of this Article, also may be governed by certain other applicable laws. This may occur in the case of a consumer lease. Section 2A-103(1)(e). Those laws may be state statutes existing prior to enactment of Article 2A or passed afterward. In this case, it is desirable for this Article to specify which statute controls. Or the law may be a pre-existing consumer protection decision. This Article preserves such decisions. Or the law may be a statute of the United States. Such a law controls without any statement in this Article under applicable principles of preemption.

An illustration of a statute of the United States that governs consumer leases is the Consumer Leasing Act, 15 U.S.C. §§ 1667-1667(e) (1982) and its implementing regulation, Regulation M, 12 C.F.R. § 213 (1986); the statute mandates disclosures of certain lease terms, delimits the liability of a lessee in leasing personal property, and regulates the advertising of lease terms. An illustration of a state statute that governs consumer leases and which if adopted in the enacting state prevails over this Article is the Unif. Consumer Credit Code, which includes many provisions similar to those of the Consumer Leasing Act, e.g. Unif. Consumer Credit Code §§ 3.202, 3.209, 3.401, 7A U.L.A. 108-09, 115, 125 (1974), as well as provisions in addition to those of the Consumer Leasing Act, e.g., Unif. Consumer Credit Code §§ 5.109-.111, 7A U.L.A. 171-76 (1974) (the right to cure a default). Such statutes may define consumer lease so as to govern transactions within and without the definition of consumer lease under this Article.

3. Under subsection (2), subject to certain limited exclusions, in case of conflict a statute or a decision described in subsection (1) prevails over this Article. For example, a provision like Unif. Consumer Credit Code § 5.112, 7A U.L.A. 176 (1974), limiting self-help repossession, prevails over Section 2A-525(3). A consumer protection decision rendered after the effective date of this Article may supplement its provisions. For example, in relation to Article 9 a court might conclude that an acceleration clause may not be enforced against an individual debtor after late payments have been accepted unless a prior notice of default is given. To the extent the decision establishes a general principle applicable to transactions other than secured transactions, it may supplement Section 2A-502.

4. Consumer protection in lease transactions is primarily left to other law. However, several provisions of this Article do contain special rules that may not be varied by agreement in the case of a consumer lease. E.g., Sections 2A-106, 2A-108, and 2A-109(2). Were that not so, the ability of the parties to govern their relationship by agreement together with the position of the lessor in a consumer lease too often could result in a one-sided lease agreement.

5. In construing this provision the reference to statute should be deemed to include applicable regulations. A consumer protection decision is "final" on the effective date of this Article if it is not subject to appeal on that date or, if subject to appeal, is not later reversed on appeal. Of course, such a decision can be overruled by a later decision or superseded by a later statute.

Cross References:
Sections 2A-103(1)(e), 2A-106, 2A-108, 2A-109(2) and 2A-525(3).
Definitional Cross Reference:
"Lease". Section 2A-103(1)(j).

4-2.5-105. Territorial application of article to goods covered by certificate of title. Subject to the provisions of sections 4-2.5-304 (3) and 4-2.5-305 (3), with respect to goods covered by a certificate of title issued under a statute of this state or of another jurisdiction, compliance and the effect of compliance or noncompliance with a certificate of title statute are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until the earlier of (a) surrender of the certificate, or (b) four months after the goods are removed from that jurisdiction and thereafter until a new certificate of title is issued by another jurisdiction.

Source: L. 91: Entire article added, p. 277, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-103(2)(a) and (b).
Changes: Substantially revised. The provisions of the last sentence of Section 9-103(2)(b) have not been incorporated as it is superfluous in this context. The provisions of Section 9-103(2)(d) have not been incorporated because the problems dealt with are adequately addressed by this section and Sections 2A-304(3) and 305(3).
Purposes: The new certificate referred to in (b) must be permanent, not temporary. Generally, the lessor or creditor whose interest is indicated on the most recently issued certificate of title will prevail over interests indicated on certificates issued previously by other jurisdictions. This provision reflects a policy that it is reasonable to require holders of interests in goods covered by a certificate of title to police the goods or risk losing their interests when a new certificate of title is issued by another jurisdiction.
Cross References:
Sections 2A-304(3), 2A-305(3), 9-103(2)(b) and 9103(2)(d).
Definitional Cross Reference:
"Goods". Section 2A-103(1)(h).

4-2.5-106. Limitation on power of parties to consumer lease to choose applicable law and judicial forum. (1) If the law chosen by the parties to a consumer lease is that of a jurisdiction other than a jurisdiction in which the lessee resides at the time the lease agreement becomes enforceable or within thirty days thereafter or in which the goods are to be used, the choice is not enforceable.

(2) If the judicial forum chosen by the parties to a consumer lease is a forum that would not otherwise have jurisdiction over the lessee, the choice is not enforceable.

Source: L. 91: Entire article added, p. 278, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Unif. Consumer Credit Code § 1.201(8), 7A U.L.A. 36 (1974).
Changes: Substantially revised.
Purposes:

There is a real danger that a lessor may induce a consumer lessee to agree that the applicable law will be a jurisdiction that has little effective consumer protection, or to agree that the applicable forum will be a forum that is inconvenient for the lessee in the event of litigation. As a result, this section invalidates these choice of law or forum clauses, except where the law chosen is that of the state of the consumer's residence or where the goods will be kept, or the forum chosen is one that otherwise would have jurisdiction over the lessee.

Subsection (1) limits potentially abusive choice of law clauses in consumer leases. The 30-day rule in subsection (1) was suggested by Section 9-103(1)(c). This section has no effect on choice of law clauses in leases that are not consumer leases. Such clauses would be governed by other law.

Subsection (2) prevents enforcement of potentially abusive jurisdictional consent clauses in consumer leases. By using the term judicial forum, this section does not limit selection of a nonjudicial forum, such as arbitration. This section has no effect on choice of forum clauses in leases that are not consumer leases; such clauses are, as a matter of current law, "prima facie valid". The Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 10 (1972). Such clauses would be governed by other law, including the Model Choice of Forum Act (1968).
Cross Reference:
Section 9-103(1)(c).
Definitional Cross References:
"Consumer lease". Section 2A-103(1)(e).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Goods". Section 2A-103(1)(h).
"Party". Section 1-201(29).

ANNOTATION

Private parties cannot enter into a forum selection clause simply to deprive a court of its subject matter jurisdiction. Vanderbeek v. Vernon Corp., 25 P.3d 1242 (Colo. App. 2000), aff'd, 50 P.3d 866 (Colo. 2002); Edge Telecom, Inc. v. Sterling Bank, 143 P.3d 1155 (Colo. App. 2006).

4-2.5-107. Waiver or renunciation of claim or right after default. Any claim or right arising out of an alleged default or breach of warranty may be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.

Source: L. 91: Entire article added, p. 278, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-107.
Changes: Revised to reflect leasing practices and terminology. This clause is used throughout the official comments to this Article to indicate the scope of change in the provisions of the Uniform Statutory Source included in the section; these changes range from one extreme, e.g., a significant difference in practice (a warranty as to merchantability is not implied in a finance lease (Section 2A-212)) to the other extreme, e.g., a modest difference in style or terminology (the transaction governed is a lease not a sale (Section 2A-203)).
Cross References:
Sections 2A-203 and 2A-212.
Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Delivery". Section 1-201(14).
"Rights". Section 1-201(36).
"Signed". Section 1-201(39).
"Written". Section 1-201(46).

4-2.5-108. Unconscionability. (1) If the court as a matter of law finds a lease contract or any clause of a lease contract to have been unconscionable at the time it was made the court may refuse to enforce the lease contract, or it may enforce the remainder of the lease contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) With respect to a consumer lease, if the court as a matter of law finds that a lease contract or any clause of a lease contract has been induced by unconscionable conduct or that unconscionable conduct has occurred in the collection of a claim arising from a lease contract, the court may grant appropriate relief.

(3) Before making a finding of unconscionability under subsection (1) or (2) of this section, the court, on its own motion or that of a party, shall afford the parties a reasonable opportunity to present evidence as to the setting, purpose, and effect of the lease contract or clause thereof, or of the conduct.

(4) In an action in which the lessee claims unconscionability with respect to a consumer lease:

(a) If the court finds unconscionability under subsection (1) or (2) of this section, the court shall award reasonable attorney's fees to the lessee.

(b) If the court does not find unconscionability and the lessee claiming unconscionability has brought or maintained an action he or she knew to be groundless, the court shall award reasonable attorney's fees to the party against whom the claim is made.

(c) In determining attorney's fees, the amount of the recovery on behalf of the claimant under subsections (1) and (2) of this section is not controlling.

Source: L. 91: Entire article added, p. 278, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-302 and Unif. Consumer Credit Code § 5.108, 7A U.L.A. 167-69 (1974).
Changes: Subsection (1) is taken almost verbatim from the provisions of Section 2-302(1). Subsection (2) is suggested by the provisions of Unif. Consumer Credit Code § 5.108(1), (2), 7A U.L.A. 167 (1974). Subsection (3), taken from the provisions of Section 2-302(2), has been expanded to cover unconscionable conduct. Unif. Consumer Credit Code § 5.108(3), 7A U.L.A. 167 (1974). The provision for the award of attorney's fees to consumers, subsection (4), covers unconscionability under subsection (1) as well as (2). Subsection (4) is modeled on the provisions of Unif. Consumer Credit Code § 5.108(6), 7A U.L.A. 169 (1974).
Purposes:
Subsections (1) and (3) of this section apply the concept of unconscionability reflected in the

provisions of Section 2-302 to leases. See Dillman & Assocs. v. Capitol Leasing Co., 110 Ill. App. 3d 335, 342, 442 N.E.2d 311, 316 (App. Ct. 1982). Subsection (3) omits the adjective "commercial" found in subsection 2-302(2) because subsection (3) is concerned with all leases and the relevant standard of conduct is determined by the context.

The balance of the section is modeled on the provisions of Unif. Consumer Credit Code § 5.108, 7A U.L.A. 167-69 (1974). Thus subsection (2) recognizes that a consumer lease or a clause in a consumer lease may not itself be unconscionable but that the agreement would never have been entered into if unconscionable means had not been employed to induce the consumer to agree. To make a statement to induce the consumer to lease the goods, in the expectation of invoking an integration clause in the lease to exclude the statement's admissibility in a subsequent dispute, may be unconscionable. Subsection (2) also provides a consumer remedy for unconscionable conduct, such as using or threatening to use force or violence, in the collection of a claim arising from a lease contract. These provisions are not exclusive. The remedies of this section are in addition to remedies otherwise available for the same conduct under other law, for example, an action in tort for abusive debt collection or under another statute of this State for such conduct. The reference to appropriate relief in subsection (2) is intended to foster liberal administration of this remedy. Sections 2A-103(4) and 1-106(1).

Subsection (4) authorizes an award of reasonable attorney's fees if the court finds unconscionability with respect to a consumer lease under subsections (1) or (2). Provision is also made for recovery by the party against whom the claim was made if the court does not find unconscionability and does find that the consumer knew the action to be groundless. Further, subsection (4)(b) is independent of, and thus will not override, a term in the lease agreement that provides for the payment of attorney's fees.

Cross References:

Sections 1-106(1), 2-302 and 2A-103(4).

Definitional Cross References:

"Action". Section 1-201(1).
"Consumer lease". Section 2A-103(1)(e).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Party". Section 1-201(29).

4-2.5-109. Option to accelerate at will. (1) A term providing that one party or his or her successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or "when he or she deems himself or herself insecure" or in words of similar import must be construed to mean that he or she has power to do so only if he or she in good faith believes that the prospect of payment or performance is impaired.

(2) With respect to a consumer lease, the burden of establishing good faith under subsection (1) of this section is on the party who exercised the power; otherwise the burden of establishing lack of good faith is on the party against whom the power has been exercised.

Source: L. 91: Entire article added, p. 279, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 1-208 and Unif. Consumer Credit Code 5.109(2), 7A U.L.A. 171 (1974).

Purposes:

Subsection (1) reflects modest changes in style to the provisions of the first sentence of Section 1-208.

Subsection (2), however, reflects a significant change in the provisions of the second sentence of Section 1-208 by creating a new rule with respect to a consumer lease. A lease provision allowing acceleration at the will of the lessor or when the lessor deems itself insecure is of critical importance to the lessee. In a consumer lease it is a provision that is not usually agreed to by the parties but is usually mandated by the lessor. Therefore, where its invocation depends not on specific criteria but on the discretion of the lessor, its use should be regulated to prevent abuse. Subsection (1) imposes a duty of good faith upon its exercise. Subsection (2) shifts the burden of establishing good faith to the lessor in the case of a consumer lease, but not otherwise.

Cross Reference:

Section 1-208.

Definitional Cross References:

"Burden of establishing". Section 1-201(8).
"Consumer lease". Section 2A-103(1)(e).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Party". Section 1-201(29).
"Term". Section 1-201(42).

PART 2

FORMATION AND CONSTRUCTION OF LEASE CONTRACT

4-2.5-201. Statute of frauds. (1) A lease contract is not enforceable by way of action or defense unless:

(a) The total payments to be made under the lease contract, excluding payments for options to renew or buy, are less than one thousand dollars; or

(b) There is a writing, signed by the party against whom enforcement is sought or by that party's authorized agent, sufficient to indicate that a lease contract has been made between the parties and to describe the goods leased and the lease term.

(2) Any description of leased goods or of the lease term is sufficient and satisfies subsection (1) (b) of this section, whether or not it is specific, if it reasonably identifies what is described.

(3) A writing is not insufficient because it omits or incorrectly states a term agreed upon, but the lease contract is not enforceable under subsection (1) (b) of this section beyond the lease term and the quantity of goods shown in the writing.

(4) A lease contract that does not satisfy the requirements of subsection (1) of this section, but which is valid in other respects, is enforceable:

(a) If the goods are to be specially manufactured or obtained for the lessee and are not suitable for lease or sale to others in the ordinary course of the lessor's business, and the lessor, before notice of repudiation is received and under circumstances that reasonably indicate that the goods are for the lessee, has made either a substantial beginning of their manufacture or commitments for their procurement;

(b) If the party against whom enforcement is sought admits in that party's pleading, testimony or otherwise in court that a lease contract was made, but the lease contract is not enforceable under this provision beyond the quantity of goods admitted; or

(c) With respect to goods that have been received and accepted by the lessee.

(5) The lease term under a lease contract referred to in subsection (4) of this section is:

(a) If there is a writing signed by the party against whom enforcement is sought or by that party's authorized agent specifying the lease term, the term so specified;

(b) If the party against whom enforcement is sought admits in that party's pleading, testimony, or otherwise in court a lease term, the term so admitted; or

(c) A reasonable lease term.

Source: L. 91: Entire article added, p. 279, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-201, 9-203(1) and 9-110.

Changes: This section is modeled on Section 2-201, with changes to reflect the differences between a lease contract and a contract for the sale of goods. In particular, subsection (1)(b) adds a requirement that the writing "describe the goods leased and the lease term", borrowing that concept, with revisions, from the provisions of Section 9-203(1)(a). Subsection (2), relying on the statutory analogue in Section 9-110, sets forth the minimum criterion for satisfying that requirement.

Purposes: The changes in this section conform the provisions of Section 2-201 to custom and usage in lease transactions. Section 2-201(2), stating a special rule between merchants, was not included in this section as the number of such transactions involving leases, as opposed to sales, was thought to be modest. Subsection (4) creates no exception for transactions where payment has been made and accepted. This represents a departure from the analogue, Section 2-201(3)(c). The rationale for the departure is grounded in the distinction between sales and leases. Unlike a buyer in a sales transaction, the lessee does not tender payment in full for goods delivered, but only payment of rent for one or more months. It was decided that, as a matter of policy, this act of payment is not a sufficient substitute for the required memorandum. Subsection (5) was needed to establish the criteria

for supplying the lease term if it is omitted, as the lease contract may still be enforceable under subsection (4).

Cross References:

Sections 2-201, 9-110 and 9-203(1)(a).

Definitional Cross References:

"Action". Section 1-201(1).
"Agreed". Section 1-201(3).
"Buying". Section 2A-103(1)(a).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Sale". Section 2-106(1).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

4-2.5-202. Final written expression: Parol or extrinsic evidence. (1) Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:

(a) By course of dealing or usage of trade or by course of performance; and

(b) By evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

Source: L. 91: Entire article added, p. 280, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-202.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Course of dealing". Section 1-205.
"Party". Section 1-201(29).
"Term". Section 1-201(42).
"Usage of trade". Section 1-205.
"Writing". Section 1-201(46).

4-2.5-203. Seals inoperative. The affixing of a seal to a writing evidencing a lease contract or an offer to enter into a lease contract does not render the writing a sealed instrument and the law with respect to sealed instruments does not apply to the lease contract or offer.

Source: L. 91: Entire article added, p. 280, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-203.

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Lease contract". Section 2A-103(1)(l).
"Writing". Section 1-201(46).

4-2.5-204. Formation in general. (1) A lease contract may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of a lease contract.

(2) An agreement sufficient to constitute a lease contract may be found although the moment of its making is undetermined.

(3) Although one or more terms are left open, a lease contract does not fail for indefiniteness if the parties have intended to make a lease contract and there is a reasonably certain basis for giving an appropriate remedy.

Source: L. 91: Entire article added, p. 281, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-204.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Agreement". Section 1-201(3).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Term". Section 1-201(42).

4-2.5-205. Firm offers. An offer by a merchant to lease goods to or from another person in a signed writing that by its terms gives assurance it will be held open is not revocable, for lack of consideration, during the time stated or, if no time is stated, for a reasonable time, but in no event may the period of irrevocability exceed three months. Any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

Source: L. 91: Entire article added, p. 281, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-205.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Merchant". Section 2-104(1).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

4-2.5-206. Offer and acceptance in formation of lease contract. (1) Unless otherwise unambiguously indicated by the language or circumstances, an offer to make a lease contract must be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances.

(2) If the beginning of a requested performance is a reasonable mode of acceptance, an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

Source: L. 91: Entire article added, p. 281, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-206(1)(a) and (2).
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Lease contract". Section 2A-103(1)(l).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).

4-2.5-207. Course of performance or practical construction. (1) If a lease contract involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection is relevant to determine the meaning of the lease agreement.

(2) The express terms of a lease agreement and any course of performance, as well as any course of dealing and usage of trade, must be construed whenever reasonable as consistent with each other; but if that construction is unreasonable, express terms control course of performance, course of performance controls both course of dealing and usage of trade, and course of dealing controls usage of trade.

(3) Subject to the provisions of section 4-2.5-208 on modification and waiver, course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

Source: L. 91: Entire article added, p. 281, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-208 and 1-205(4).
Changes: Revised to reflect leasing practices and terminology, except that subsection (2) was further revised to make the subsection parallel the provisions of Section 1-205(4) by adding that course of dealing controls usage of trade.
Purposes: The section should be read in conjunction with Section 2A-208. In particular, although a specific term may control over course of performance as a matter of lease construction under subsection (2), subsection (3) allows the same course of dealing to show a waiver or modification, if Section 2A-208 is satisfied.
Cross References:
Sections 1-205(4), 2-208 and 2A-208.
Definitional Cross References:
"Course of dealing". Section 1-205.
"Knowledge". Section 1-201(25).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Term". Section 1-201(42).
"Usage of trade". Section 1-205.

4-2.5-208. Modification, rescission and waiver. (1) An agreement modifying a lease contract needs no consideration to be binding.

(2) A signed lease agreement that excludes modification or rescission except by a signed writing may not be otherwise modified or rescinded, but, except as between merchants, such a requirement on a form supplied by a merchant must be separately signed by the other party.

(3) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) of this section, it may operate as a waiver.

(4) A party who has made a waiver affecting an executory portion of a lease contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

Source: L. 91: Entire article added, p. 282, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-209.
Changes: Revised to reflect leasing practices and terminology, except that the provisions of subsection 2- 209(3) were omitted.
Purposes: Section 2-209(3) provides that "the requirements of the statute of frauds section of this Article (Section 2-201) must be satisfied if the contract as modified is within its provisions." This provision was not incorporated as it is unfair to allow an oral modification to make the entire lease contract unenforceable, e.g. if the modification takes it a few dollars over the dollar limit. At the same time, the problem could not be solved by providing that the lease contract would still be enforceable in its premodification state (if it then satisfied the statute of frauds) since in some cases that might be worse than no enforcement at all. Resolution of the issue is left to the courts based on the facts of each case.
Cross References:
Sections 2-201 and 2-209.
Definitional Cross References:
"Agreement". Section 1-201(3).
"Between merchants". Section 2-104(3).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Merchant". Section 2-104(1).
"Notification". Section 1-201(26).
"Party". Section 1-201(29).
"Signed". Section 1-201(39).
"Term". Section 1-201(42).
"Writing". Section 1-201(46).

4-2.5-209. Lessee under finance lease as beneficiary of supply contract. (1) The benefit of the supplier's promises to the lessor under the supply contract and of all warranties, whether express or implied, including those of any third party provided in connection with or as a part of the supply contract, extends to the lessee to the extent of the lessee's leasehold interest under a finance lease related to the supply contract, but is subject to the terms of the warranty and of the supply contract and all defenses or claims arising therefrom.

(2) The extension of the benefit of a supplier's promises and of warranties to the lessee (section 4-2.5-209 (1)) does not: (i) modify the rights and obligations of the parties to the supply contract, whether arising therefrom or otherwise, or (ii) impose any duty or liability under the supply contract on the lessee.

(3) Any modification or rescission of the supply contract by the supplier and the lessor is effective between the supplier and the lessee unless, before the modification or rescission, the supplier has received notice that the lessee has entered into a finance lease related to the supply contract. If the modification or rescission is effective between the supplier and the lessee, the lessor is deemed to have assumed, in addition to the obligations of the lessor to the lessee under the lease contract, promises of the supplier to the lessor and warranties that were so modified or rescinded as they existed and were available to the lessee before modification or rescission.

(4) In addition to the extension of the benefit of the supplier's promises and of warranties to the lessee under subsection (1) of this section, the lessee retains all rights that the lessee may have against the supplier which arise from an agreement between the lessee and the supplier or under other law.

Source: L. 91: Entire article added, p. 282, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: None.

Changes: This section is modeled on Section 9-318, the Restatement (Second) of Contracts § § 302-315 (1981), and leasing practices. See Earman Oil Co. v. Burroughs Corp., 625 F.2d 1291, 1296-97 (5th Cir. 1980).

Purposes:

1. The function performed by the lessor in a finance lease is extremely limited. Section 2A-103(1)(g). The lessee looks to the supplier of the goods for warranties and the like or, in some cases as to warranties, to the manufacturer if a warranty made by that person is passed on. That expectation is reflected in subsection (1), which is self-executing. As a matter of policy, the operation of this provision may not be excluded, modified or limited; however, an exclusion, modification, or limitation of any term of the supply contract or warranty, including any with respect to rights and remedies, and any defense or claim such as a statute of limitations, effective against the lessor as the acquiring party under the supply contract, is also effective against the lessee as the beneficiary designated under this provision. For example, the supplier is not precluded from excluding or modifying an express or implied warranty under a supply contract. Sections 2-312(2) and 2-316, or Section 2A-214. Further, the supplier is not precluded from limiting the rights and remedies of the lessor and from liquidating damages. Sections 2-718 and 2-719 or Sections 2A-503 and 2A-504. If the supply contract excludes or modifies warranties, limits remedies, or liquidates damages with respect to the lessor, such provisions are enforceable against the lessee as beneficiary. Thus, only selective discrimination against the beneficiaries designated under this section is precluded, i.e., exclusion of the supplier's liability to the lessee with respect to warranties made to the lessor. This section does not affect the development of other law with respect to products liability.

2. Enforcement of this benefit is by action. Sections 2A-103(4) and 1-106(2).

3. The benefit extended by these provisions is not without a price, as this Article also provides in the case of a finance lease that is not a consumer lease that the lessee's promises to the lessor under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods. Section 2A-407.

4. Subsection (2) limits the effect of subsection (1) on the supplier and the lessor by preserving, notwithstanding the transfer of the benefits of the supply contract to the lessee, all of the supplier's and the lessor's rights and obligations with respect to each other and others; it further absolves the lessee of any duties with respect to the supply contract that might have been inferred from the extension of the benefits thereof.

5. Subsections (2) and (3) also deal with difficult issues related to modification or rescission of the supply contract. Subsection (2) states a rule that determines the impact of the statutory extension of benefit contained in subsection (1) upon the relationship of the parties to the supply contract and, in a limited respect, upon the lessee. This statutory extension of benefit, like that contained in Sections 2A-216 and 2-318, is not a modification of the supply contract by the parties. Thus, subsection (3) states the rules that apply to a modification or rescission of the supply contract by the parties. Subsection (3) provides that a modification or rescission is not effective between the supplier and the lessee if, before the modification or rescission occurs, the

supplier received notice that the lessee has entered into the finance lease. On the other hand, if the modification or rescission is effective, then to the extent of the modification or rescission of the benefit or warranty, the lessor by statutory dictate assumes an obligation to provide to the lessee that which the lessee would otherwise lose. For example, assume a reduction in an express warranty from four years to one year. No prejudice to the lessee may occur if the goods perform as agreed. If, however, there is a breach of the express warranty after one year and before four years pass, the lessor is liable. A remedy for any prejudice to the lessee because of the bifurcation of the lessee's recourse resulting from the action of the supplier and the lessor is left to resolution by the courts based on the facts of each case.

6. Subsection (4) makes it clear that the rights granted to the lessee by this section do not displace any rights the lessee otherwise may have against the supplier.

Cross References:

Sections 2A-103(1)(g), 2A-407 and 9-318.

Definitional Cross References:

"Action". Section 1-201(1).
"Finance lease". Section 2A-103(1)(g).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).
"Supply contract". Section 2A-103(1)(y).
"Term". Section 1-201(42).

4-2.5-210. Express warranties. (1) Express warranties by the lessor are created as follows:

(a) Any affirmation of fact or promise made by the lessor to the lessee which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods will conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods will conform to the description.

(c) Any sample or model that is made part of the basis of the bargain creates an express warranty that the whole of the goods will conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the lessor use formal words, such as "warrant" or "guarantee," or that the lessor have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the lessor's opinion or commendation of the goods does not create a warranty.

Source: L. 91: Entire article added, p. 283, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-313.

Changes: Revised to reflect leasing practices and terminology.

Purposes:

All of the express and implied warranties of the Article on Sales (Article 2) are included in this Article, revised to reflect the differences between a sale of goods and a lease of goods. Sections 2A-210 through 2A-216. The lease of goods is sufficiently similar to the sale of goods to justify this decision. Hawkland, The Impact of the Uniform Commercial Code on Equipment Leasing, 1972 Ill. L.F. 446, 459-60. Many state and federal courts have reached the same conclusion.

Value of the goods, as used in subsection (2), includes rental value.

Cross References:

Article 2, esp. Section 2-313, and Sections 2A-210 through 2A-216.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Value". Section 1-201(44).

4-2.5-211. Warranties against interference and against infringement; lessee's obligation against infringement. (1) There is in a lease contract a warranty that for the lease term no person holds a claim to or interest in the goods that arose from an act or omission of the lessor, other than a claim by way of infringement or the like, which will interfere with the lessee's enjoyment of its leasehold interest.

(2) Except in a finance lease there is in a lease contract by a lessor who is a merchant

regularly dealing in goods of the kind a warranty that the goods are delivered free of the rightful claim of any person by way of infringement or the like.

(3) A lessee who furnishes specifications to a lessor or a supplier shall hold the lessor and the supplier harmless against any claim by way of infringement or the like that arises out of compliance with the specifications.

Source: L. 91: Entire article added, p. 283, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-312.

Changes: This section is modeled on the provisions of Section 2-312, with modifications to reflect the limited interest transferred by a lease contract and the total interest transferred by a sale. Section 2-312(2), which is omitted here, is incorporated in Section 2A-214. The warranty of quiet possession was abolished with respect to sales of goods. Section 2-312 official comment 1. Section 2A-211(1) reinstates the warranty of quiet possession with respect to leases. Inherent in the nature of the limited interest transferred by the lease - the right to possession and use of the goods - is the need of the lessee for protection greater than that afforded to the buyer. Since the scope of the protection is limited to claims or interests that arose from acts or omissions of the lessor, the lessor will be in position to evaluate the potential cost, certainly a far better position than that enjoyed by the lessee. Further, to the extent the market will allow, the lessor can attempt to pass on the anticipated additional cost to the lessee in the guise of higher rent.

Purposes: General language was chosen for subsection (1) that expresses the essence of the lessee's expectation: with an exception for infringement and the like, no person holding a claim or interest that arose from an act or omission of the lessor will be able to interfere with the lessee's use and enjoyment of the goods for the lease term. Subsection (2), like other similar provisions in later sections, excludes the finance lessor from extending this warranty; with few exceptions (Sections 2A-210 and 2A-211(1)), the lessee under a finance lease is to look to the supplier for warranties and the like or, in some cases as to warranties, to the manufacturer if a warranty made by that person is passed on. Subsections (2) and (3) are derived from Section 2-312(3). These subsections, as well as the analogue, should be construed so that applicable principles of law and equity supplement their provisions. Sections 2A-103(4) and 1-103.

Cross References:

Sections 2-312, 2-312(1), 2-312(2), 2-312 official comment 1, 2A-210, 2A-211(1) and 2A-214.

Definitional Cross References:

"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Person". Section 1-201(30).
"Supplier". Section 2A-103(1)(x).

4-2.5-212. Implied warranty of merchantability. (1) Except in a finance lease, a warranty that the goods will be merchantable is implied in a lease contract if the lessor is a merchant with respect to goods of that kind.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the description in the lease agreement;

(b) in the case of fungible goods, are of fair average quality within the description;

(c) are fit for the ordinary purposes for which goods of that type are used;

(d) run, within the variation permitted by the lease agreement, of even kind, quality, and quantity within each unit and among all units involved;

(e) are adequately contained, packaged, and labeled as the lease agreement may require; and

(f) conform to any promises or affirmations of fact made on the container or label.

(3) Other implied warranties may arise from course of dealing or usage of trade.

Source: L. 91: Entire article added, p. 284, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-314.
Changes: Revised to reflect leasing practices and terminology. E.g., Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 225, 541 P.2d 1184, 1193 (1975) (implied warranty of merchantability (Article 2) extends to lease transactions).
Definitional Cross References:
"Conforming". Section 2A-103(1)(d).
"Course of dealing". Section 1-205.
"Finance lease". Section 2A-103(1)(g).
"Fungible". Section 1-201(17).
"Goods". Section 2A-103(1)(h).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Usage of trade". Section 1-205.

4-2.5-213. Implied warranty of fitness for particular purpose. Except in a finance lease, if the lessor at the time the lease contract is made has reason to know of any particular purpose for which the goods are required and that the lessee is relying on the lessor's skill or judgment to select or furnish suitable goods, there is in the lease contract an implied warranty that the goods will be fit for that purpose.

Source: L. 91: Entire article added, p. 284, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-315.
Changes: Revised to reflect leasing practices and terminology. E.g., All-States Leasing Co. v. Bass, 96 Idaho 873, 879, 538 P.2d 1177, 1183 (1975) (implied warranty of fitness for a particular purpose (Article 2) extends to lease transactions).
Definitional Cross References:
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

4-2.5-214. Exclusion or modification of warranties. (1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit a warranty must be construed wherever reasonable as consistent with each other; but, subject to the provisions of section 4-2.5-202 on parol or extrinsic evidence, negation or limitation is inoperative to the extent that the construction is unreasonable.

(2) Subject to subsection (3) of this section, to exclude or modify the implied warranty of merchantability or any part of it the language must mention "merchantability", be by a writing, and be conspicuous. Subject to subsection (3) of this section, to exclude or modify any implied warranty of fitness the exclusion must be by a writing and be conspicuous. Language to exclude all implied warranties of fitness is sufficient if it is in writing, is conspicuous and states, for example, "There is no warranty that the goods will be fit for a particular purpose".

(3) Notwithstanding subsection (2) of this section, but subject to subsection (4) of this section,

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", or "with all faults", or by other language that in common understanding calls the lessee's attention to the exclusion of warranties and makes plain that there is no implied warranty, and if in writing conspicuous;

(b) if the lessee before entering into the lease contract has examined the goods or the sample or model as fully as desired or has refused to examine the goods, there is no implied warranty with regard to defects that an examination ought in the circumstances to have revealed; and

(c) an implied warranty may also be excluded or modified by course of dealing, course of performance, or usage of trade.

(4) To exclude or modify a warranty against interference or against infringement (section 4-2.5-211) or any part of it, the language must be specific, be by a writing, and be

conspicuous, unless the circumstances, including course of performance, course of dealing, or usage of trade, give the lessee reason to know that the goods are being leased subject to a claim or interest of any person.

Source: L. 91: Entire article added, p. 284, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-316 and 2-312(2).
Changes: Subsection (2) requires that a disclaimer of the warranty of merchantability be conspicuous and in writing as is the case for a disclaimer of the warranty of fitness; this is contrary to the rule stated in Section 2-316(2) with respect to the disclaimer of the warranty of merchantability. This section also provides that to exclude or modify the implied warranty of merchantability, fitness or against interference or infringement the language must be in writing and conspicuous. There are, however, exceptions to the rule. E.g., course of dealing, course of performance, or usage of trade may exclude or modify an implied warranty. Section 2A-214(3)(c). The analogue of Section 2-312(2) has been moved to subsection (4) of this section for a more unified treatment of disclaimers; there is no policy with respect to leases of goods that would justify continuing certain distinctions found in the Article on Sales (Article 2) regarding the treatment of the disclaimer of various warranties. Compare Sections 2-312(2) and 2-316(2). Finally, the example of a disclaimer of the implied warranty of fitness stated in subsection (2) differs from the analogue stated in Section 2-316(2); this example should promote a better understanding of the effect of the disclaimer.
Purposes: These changes were made to reflect leasing practices. E.g., FMC Finance Corp. v. Murphree, 632 F.2d 413, 418 (5th Cir. 1980) (disclaimer of implied warranty under lease transactions must be conspicuous and in writing). The omission of the provisions of Section 2-316(4) was not substantive. Sections 2A-503 and 2A-504.
Cross References:
Article 2, esp. Sections 2-312(2) and 2-316, and Sections 2A-503 and 2A-504.
Definitional Cross References:
"Conspicuous". Section 1-201(10).
"Course of dealing". Section 1-205.
"Fault". Section 2A-103(1)(f).
"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Person". Section 1-201(30).
"Usage of trade". Section 1-205.
"Writing". Section 1-201(46).

4-2.5-215. Cumulation and conflict of warranties express or implied. Warranties, whether express or implied, must be construed as consistent with each other and as cumulative, but if that construction is unreasonable, the intention of the parties determines which warranty is dominant. In ascertaining that intention the following rules apply:

(a) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) A sample from an existing bulk displaces inconsistent general language of description.

(c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

Source: L. 91: Entire article added, p. 285, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-317.
Definitional Cross Reference:
"Party". Section 1-201(29).

4-2.5-216. Third-party beneficiaries of express and implied warranties. A warranty to or for the benefit of a lessee under this article, whether express or implied, extends to any person who may reasonably be expected to use, consume, or be affected by the goods and who is injured by breach of the warranty. The operation of this section may not be excluded,

modified, or limited with respect to injury to the person of an individual to whom the warranty extends, but an exclusion, modification, or limitation of the warranty, including any with respect to rights and remedies, effective against the lessee is also effective against the beneficiary designated under this section.

Source: L. 91: Entire article added, p. 286, § 1, effective July 1, 1992.

Editor's note - Colorado legislative change: The uniform act provides three alternatives for this section. Colorado chose "ALTERNATIVE C" to parallel the changes previously made by Colorado in section 4-2-318.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-318.

Changes: The provisions of Section 2-318 have been included in this section, modified in two respects: first, to reflect leasing practice, including the special practices of the lessor under a finance lease; second, to reflect and thus codify elements of the official comment to Section 2-318 with respect to the effect of disclaimers and limitations of remedies against third parties.

Purposes:

Alternative A is based on the 1962 version of Section 2-318 and is least favorable to the injured person as the doctrine of privity imposed by other law is abrogated to only a limited extent. Alternatives B and C are based on later additions to Section 2-318 and are more favorable to the injured person. In determining which alternative to select, the state legislature should consider making its choice parallel to the choice it made with respect to Section 2-318, as interpreted by the courts.

The last sentence of each of Alternatives A, B and C does not preclude the lessor from excluding or modifying an express or implied warranty under a lease. Section 2A-214. Further, that sentence does not preclude the lessor from limiting the rights and remedies of the lessee and from liquidating damages. Sections 2A-503 and 2A-504. If the lease excludes or modifies warranties, limits remedies for breach, or liquidates damages with respect to the lessee, such provisions are enforceable against the beneficiaries designated under this section. However, this last sentence forbids selective discrimination against the beneficiaries designated under this section, i.e., exclusion of the lessor's liability to the beneficiaries with respect to warranties made by the lessor to the lessee.

Other law, including the Article on Sales (Article 2), may apply in determining the extent to which a warranty to or for the benefit of the lessor extends to the lessee and third parties. This is in part a function of whether the lessor has bought or leased the goods.

This Article does not purport to change the development of the relationship of the common law, with respect to products liability, including strict liability in tort (as restated in Restatement (Second) of Torts, 402A (1965)), to the provisions of this Act. Compare Cline v. Prowler Indus. of Maryland, 418 A.2d 968 (Del. 1980) and Hawkins Constr. Co. v. Matthews Co., 190 Neb. 546, 209 N.W.2d 643 (1973) with Dippel v. Sciano, 37 Wis. 2d 443, 155 N.W.2d 55 (1967).

Cross References:

Article 2, esp. Section 2-318, and Sections 2A-214, 2A-503 and 2A-504.

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

4-2.5-217. Identification. Identification of goods as goods to which a lease contract refers may be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement, identification occurs:

(a) When the lease contract is made if the lease contract is for a lease of goods that are existing and identified;

(b) When the goods are shipped, marked, or otherwise designated by the lessor as goods to which the lease contract refers, if the lease contract is for a lease of goods that are not existing and identified; or

(c) When the young are conceived, if the lease contract is for a lease of unborn young of animals.

Source: L. 91: Entire article added, p. 286, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501.
Changes: This section, together with Section 2A-218, is derived from the provisions of Section 2-501, with changes to reflect lease terminology; however, this section omits as irrelevant to leasing practice the treatment of special property.
Purposes: With respect to subsection (b) there is a certain amount of ambiguity in the reference to when goods are designated, e.g., when the lessor is both selling and leasing goods to the same lessee/buyer and has marked goods for delivery but has not distinguished between those related to the lease contract and those related to the sales contract. As in Section 2-501(1)(b), this issue has been left to be resolved by the courts, case by case.
Cross References:
Sections 2-501 and 2A-218.
Definitional Cross References:
"Agreement". Section 1-201(3).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).

4-2.5-218. Insurance and proceeds. (1) A lessee obtains an insurable interest when existing goods are identified to the lease contract even though the goods identified are nonconforming and the lessee has an option to reject them.

(2) If a lessee has an insurable interest only by reason of the lessor's identification of the goods, the lessor, until default or insolvency or notification to the lessee that identification is final, may substitute other goods for those identified.

(3) Notwithstanding a lessee's insurable interest under subsections (1) and (2) of this section, the lessor retains an insurable interest until an option to buy has been exercised by the lessee and risk of loss has passed to the lessee.

(4) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

(5) The parties by agreement may determine that one or more parties have an obligation to obtain and pay for insurance covering the goods and by agreement may determine the beneficiary of the proceeds of the insurance.

Source: L. 91: Entire article added, p. 286, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-501.
Changes: This section, together with Section 2A-217, is derived from the provisions of Section 2-501, with changes and additions to reflect leasing practices and terminology.
Purposes: Subsection (2) states a rule allowing substitution of goods by the lessor under certain circumstances, until default or insolvency of the lessor, or until notification to the lessee that identification is final. Subsection (3) states a rule regarding the lessor's insurable interest that, by virtue of the difference between a sale and a lease, necessarily is different from the rule stated in Section 2-501(2) regarding the seller's insurable interest. For this purpose the option to buy shall be deemed to have been exercised by the lessee when the resulting sale is closed, not when the lessee gives notice to the lessor. Further, subsection (5) is new and reflects the common practice of shifting the responsibility and cost of insuring the goods between the parties to the lease transaction.
Cross References:
Sections 2-501, 2-501(2) and 2A-217.
Definitional Cross References:
"Agreement". Section 1-201(3).
"Buying". Section 2A-103(1)(a).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Party". Section 1-201(29).

4-2.5-219. Risk of loss. (1) Except in the case of a finance lease, risk of loss is retained by the lessor and does not pass to the lessee. In the case of a finance lease, risk of loss passes to the lessee.

(2) Subject to the provisions of this article on the effect of default on risk of loss

(section 4-2.5-220), if risk of loss is to pass to the lessee and the time of passage is not stated, the following rules apply:

(a) If the lease contract requires or authorizes the goods to be shipped by carrier

(i) and it does not require delivery at a particular destination, the risk of loss passes to the lessee when the goods are duly delivered to the carrier; but

(ii) if it does require delivery at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the lessee when the goods are there duly so tendered as to enable the lessee to take delivery.

(b) If the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the lessee on acknowledgment by the bailee of the lessee's right to possession of the goods.

(c) In any case not within paragraph (a) or (b) of this subsection (2), the risk of loss passes to the lessee on the lessee's receipt of the goods if the lessor, or, in the case of a finance lease, the supplier, is a merchant; otherwise the risk passes to the lessee on tender of delivery.

Source: L. 91: Entire article added, p. 287, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-509(1) through (3).

Changes: Subsection (1) is new. The introduction to subsection (2) is new, but subparagraph (a) incorporates the provisions of Section 2-509(1); subparagraph (b) incorporates the provisions of Section 2-509(2) only in part, reflecting current practice in lease transactions.

Purposes: Subsection (1) states rules related to retention or passage of risk of loss consistent with current practice in lease transactions. The provisions of subsection (4) of Section 2-509 are not incorporated as they are not necessary. This section does not deal with responsibility for loss caused by the wrongful act of either the lessor or the lessee.

Cross References:

Sections 2-509(1), 2-509(2) and 2-509(4).

Definitional Cross References:

"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

4-2.5-220. Effect of default on risk of loss. (1) Where risk of loss is to pass to the lessee and the time of passage is not stated:

(a) If a tender or delivery of goods so fails to conform to the lease contract as to give a right of rejection, the risk of their loss remains with the lessor, or, in the case of a finance lease, the supplier, until cure or acceptance.

(b) If the lessee rightfully revokes acceptance, he or she, to the extent of any deficiency in his or her effective insurance coverage, may treat the risk of loss as having remained with the lessor from the beginning.

(2) Whether or not risk of loss is to pass to the lessee, if the lessee as to conforming goods already identified to a lease contract repudiates or is otherwise in default under the lease contract, the lessor, or, in the case of a finance lease, the supplier, to the extent of any deficiency in his or her effective insurance coverage may treat the risk of loss as resting on the lessee for a commercially reasonable time.

Source: L. 91: Entire article added, p. 287, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-510.

Changes: Revised to reflect leasing practices and terminology. The rule in Section (1)(b) does not allow the lessee under a finance lease to treat the risk of loss as having remained with the supplier from the beginning. This is appropriate

given the limited circumstances under which the lessee under a finance lease is allowed to revoke acceptance. Section 2A-517 and Section 2A-516 official comment.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

4-2.5-221. Casualty to identified goods. If a lease contract requires goods identified when the lease contract is made, and the goods suffer casualty without fault of the lessee, the lessor or the supplier before delivery, or the goods suffer casualty before risk of loss passes to the lessee pursuant to the lease agreement or section 4-2.5-219, then:

(a) If the loss is total, the lease contract is avoided; and

(b) If the loss is partial or the goods have so deteriorated as to no longer conform to the lease contract, the lessee may nevertheless demand inspection and at his or her option either treat the lease contract as avoided or, except in a finance lease that is not a consumer lease, accept the goods with due allowance from the rent payable for the balance of the lease term for the deterioration or the deficiency in quantity but without further right against the lessor.

Source: L. 91: Entire article added, p. 288, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-613.

Changes: Revised to reflect leasing practices and terminology.

Purposes: Due to the vagaries of determining the amount of due allowance (Section 2-613(b)), no attempt was made in subsection (b) to treat a problem unique to lease contracts and installment sales contracts: determining how to recapture the allowance, e.g., application to the first or last rent payments or allocation, pro rata, to all rent payments.

Cross References:

Section 2-613.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Fault". Section 2A-103(1)(f).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).

PART 3

EFFECT OF LEASE CONTRACT

4-2.5-301. Enforceability of lease contract. Except as otherwise provided in this article, a lease contract is effective and enforceable according to its terms between the parties, against purchasers of the goods and against creditors of the parties.

Source: L. 91: Entire article added, p. 288, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-201.

Changes: The first sentence of Section 9-201 was incorporated, modified to reflect leasing terminology. The second sentence of Section 9-201 was eliminated as not relevant to leasing practices.

Purposes:

1. This section establishes a general rule regarding the validity and enforceability of a lease contract. The lease contract is effective and enforceable between the parties and against third parties. Exceptions to this general rule

arise where there is a specific rule to the contrary in this Article. Enforceability is, thus, dependent upon the lease contract meeting the requirements of the Statute of Frauds provisions of Section 2A-201. Enforceability is also a function of the lease contract conforming to the principles of construction and interpretation contained in the Article on General Provisions (Article 1). Section 2A-103(4).

2. The effectiveness or enforceability of the lease contract is not dependent upon the lease contract or any financing statement or the like being filed or recorded; however, the priority of the interest of a lessor of fixtures with respect to the interests of certain third parties in such fixtures is subject to the provisions of the Article on Secured Transactions (Article 9). Section 2A-309. Prior to the adoption of this Article filing or recording was not required with respect to leases, only leases intended as security. The definition of security interest, as amended concurrently with the adoption of this Article, more clearly delineates leases and leases intended as security and thus signals the need to file. Section 1-201(37). Those lessors who are concerned about whether the transaction creates a lease or a security interest will continue to file a protective financing statement. Section 9-408. Coogan, Leasing and the Uniform Commercial Code, in Equipment Leasing-Leveraged Leasing 681, 744-46 (2d ed. 1980).

3. Hypothetical:

(a) In construing this section it is important to recognize its relationship to other sections in this Article. This is best demonstrated by reference to a hypothetical. Assume that on February 1 A, a manufacturer of combines and other farm equipment, leased a fleet of six combines to B, a corporation engaged in the business of farming, for a 12 month term. Under the lease agreement between A and B, A agreed to defer B's payment of the first two months' rent to April 1. On March 1 B recognized that it would need only four combines and thus subleased two combines to C for an 11 month term.

(b) This hypothetical raises a number of issues that are answered by the sections contained in this part. Since lease is defined to include sublease (Section 2A-103(1)(j) and (w)), this section provides that the prime lease between A and B and the sublease between B and C are enforceable in accordance with their terms, except as otherwise provided in this Article; that exception, in this case, is one of considerable scope.

(c) The separation of ownership, which is in A, and possession, which is in B with respect to four combines and which is in C with respect to two combines, is not relevant. Section 2A-302. A's interest in the six combines cannot be challenged simply because A parted with possession to B, who in turn parted with possession of some of the combines to C. Yet it is important to note that by the terms of Section 2A-302 this conclusion is subject to change if otherwise provided in this Article.

(d) B's entering the sublease with C raises an issue that is treated by this part. In a dispute over the leased combines A may challenge B's right to sublease. The rule is permissive as to transfers of interests under a lease contract, including subleases. Section 2A-303(2). However, the rule has two significant qualifications. If the prime lease contract between A and B prohibits B from subleasing the combines, or makes such a sublease an event of default, Section 2A-303(2) applies; thus, while B's interest under the prime lease may be transferred under the sublease to C, A may have a remedy pursuant to Section 2A-303(5). Absent a prohibition or default provision in the prime lease contract A might be able to argue that the sublease to C materially increases A's risk; thus, while B's interest under the prime lease may not be transferred under the sublease to C, A may have a remedy pursuant to Section 2A-303(5). Section 2A-303(5)(b)(ii).

(e) Resolution of this issue is also a function of the section dealing with the sublease of goods by a prime lessee (Section 2A-305). Subsection (1) of Section 2A-305, which is subject to the rules of Section 2A-303 stated above, provides that C takes subject to the interest of A under the prime lease between A and B. However, there are two exceptions. First, if B is a merchant (Sections 2A-103(3) and 2- 104(1)) dealing in goods of that kind and C is a sublessee in the ordinary course of business (Sections 2A-103(1)(o) and 2A-103(1)(n)), C takes free of the prime lease between A and B. Second, if B has rejected the six combines under the prime lease with A, and B disposes of the goods by sublease to C, C takes free of the prime lease if C can establish good faith. Section 2A-511(4).

(f) If the facts of this hypothetical are expanded and we assume that the prime lease obligated B to maintain the combines, an additional issue may be presented. Prior to entering the sublease, B, in satisfaction of its maintenance covenant, brought the two combines that it desired to sublease to a local independent dealer of A's. The dealer did the requested work for B. C inspected the combines on the dealer's lot after the work was completed. C signed the sublease with B two days later. C, however, was prevented from taking delivery of the two combines as B refused to pay the dealer's invoice for the repairs. The dealer furnished the repair service to B in the ordinary course of the dealer's business. If under applicable law the dealer has a lien on repaired goods in the dealer's possession, the dealer's lien will take priority over B's and C's interests, and also should take priority over A's interest, depending upon the terms of the lease contract and the applicable law. Section 2A-306.

(g) Now assume that C is in financial straits and one of C's creditors obtains a judgment against C. If the creditor levies on C's subleasehold interest in the two combines, who will prevail? Unless the levying creditor also holds a lien covered by Section 2A-306, discussed above, the judgment creditor will take its interest subject to B's rights under the sublease and A's rights under the prime lease. Section 2A-307(1). The hypothetical becomes more complicated if we assume that B is in financial straits and B's creditor holds the judgment. Here the judgment creditor takes subject to the sublease unless the lien attached to the two combines before the sublease contract became enforceable. Section 2A-307(2)(a). However, B's judgment creditor cannot prime A's interest in the goods because, with respect to A, the judgment creditor is a creditor of B in its capacity as lessee under the prime lease between A and B. Thus, here the judgment creditor's interest is subject to the lease between A and B. Section 2A-307(1).

(h) Finally, assume that on April 1 B is unable to pay A the deferred rent then due under the prime lease, but that C is current in its payments under the sublease from B. What effect will B's default under the prime lease between A and B have on C's rights under the sublease between B and C? Section 2A-301 provides that a lease contract is effective against the creditors of either party. Since a lease contract includes a sublease contract (Section 2A-103(1)(l)), the sublease contract between B and C arguably could be enforceable against A, a prime lessor who has extended unsecured credit to B, the prime lessee/sublessor, if the sublease contract meets the requirements of Section 2A-201. However, the rule stated in Section 2A-301 is subject to other provisions in this Article. Under Section 2A-305, C, as sublessee, would take subject to the prime lease contract in most cases. Thus, B's default under the prime lease will in most cases lead to A's recovery of the goods from C. Section 2A-523. A and C could provide otherwise by agreement. Section 2A-311. C's recourse will be to assert a claim for damages against B. Sections 2A-211(1) and 2A-508.

4. Relationship Between Sections:

(a) As the analysis of the hypothetical demonstrates, Part 3 of the Article focuses on issues that relate to the enforceability of the lease contract (Sections 2A-301, 2A-302 and 2A-303) and to the priority of various claims to the goods subject to the lease contract (Sections 2A-304, 2A-305, 2A-306, 2A-307, 2A-308, 2A-309, 2A-310, and 2A-311).

(b) This section states a general rule of enforceability, which is subject to specific rules to the contrary stated elsewhere in the Article. Section 2A-302 negates any notion that the separation of title and possession is fraudulent as a rule of law. Finally, Section 2A-303 states rules with respect to the transfer of the lessor's interest (as well as the residual interest in the goods) or the lessee's interest under the lease contract. Conditions Qualifications are imposed as a function of various issues, including whether the transfer is the creation or enforcement of a security interest or one that is material to the other party to the lease contract. In addition, a system of rules is created to deal with the rights and duties among assignor, assignee and the other party to the lease contract.

(c) Sections 2A-304 and 2A-305 are twins that deal with good faith transferees of goods subject to the lease contract. Section 2A-304 creates a set of rules with respect to transfers by the lessor of goods subject to a lease contract; the transferee considered is a subsequent lessee of the goods. The priority dispute covered here is between the subsequent lessee and the original lessee of the goods (or persons claiming through the original lessee). Section 2A-305 creates a set of rules with respect to transfers by the lessee of goods subject to a lease contract; the transferees considered are buyers of the goods or sublessees of the goods. The priority dispute covered here is between the transferee and the lessor of the goods (or persons claiming through the lessor).

(d) Section 2A-306 creates a rule with respect to priority disputes between holders of liens for services or materials furnished with respect to goods subject to a lease contract and the lessor or the lessee under that contract. Section 2A-307 creates a rule with respect to priority disputes between the lessee and creditors of the lessor and priority disputes between the lessor and creditors of the lessee.

(e) Section 2A-308 creates a series of rules relating to allegedly fraudulent transfers and preferences. The most significant rule is that set forth in subsection (3) which validates sale-leaseback transactions if the buyer-lessor can establish that he or she bought for value and in good faith.

(f) Sections 2A-309 and 2A-310 create a series of rules with respect to priority disputes between various third parties and a lessor of fixtures or accessions, respectively, with respect thereto.

(g) Finally, Section 2A-311 allows parties to alter the statutory priorities by agreement.

Cross References:

Article 1, especially Section 1-201(37), and Sections 2-104(1), 2A-103(1)(j), 2A-103(1)(l), 2A-103(1)(n), 2A-103(1)(o) and 2A-103(1)(w), 2A-103(3), 2A-103(4), 2A-201, 2A-301 through 2A-303, 2A-303(2), 2A-303(5), 2A-304 through 2A-307, 2A-307(1), 2A-307(2)(a), 2A-308 through 2A-311, 2A-508, 2A-511(4), 2A-523, Article 9, especially Sections 9-201 and 9-408.

Definitional Cross References:

"Creditor". Section 1-201(12).

"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Purchaser". Section 1-201(33).
"Term". Section 1-201(42).

4-2.5-302. Title to and possession of goods. Except as otherwise provided in this article, each provision of this article applies whether the lessor or a third party has title to the goods, and whether the lessor, the lessee, or a third party has possession of the goods, notwithstanding any statute or rule of law that possession or the absence of possession is fraudulent.

Source: L. 91: Entire article added, p. 288, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-202.
Changes: Section 9-202 was modified to reflect leasing terminology and to clarify the law of leases with respect to fraudulent conveyances or transfers.
Purposes: The separation of ownership and possession of goods between the lessor and the lessee (or a third party) has created problems under certain fraudulent conveyance statutes. See, e.g., In re Ludlum Enters., 510 F.2d 996 (5th Cir. 1975); Suburbia Fed. Sav. & Loan Ass'n v. Bel-Air Conditioning Co., 385 So. 2d 1151 (Fla. Dist. Ct. App. 1980). This section provides, among other things, that separation of ownership and possession per se does not affect the enforceability of the lease contract. Sections 2A-301 and 2A-308.
Cross References:
Sections 2A-301, 2A-308 and 9-202.
Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

4-2.5-303. Alienability of party's interest under lease contract or of lessor's residual interest in goods; delegation of performance; transfer of rights. (1) As used in this section, "creation of a security interest" includes the sale of a lease contract that is subject to article 9 of this title by reason of section 4-9-109 (a) (3).

(2) Except as provided in subsection (3) of this section and section 4-9-407, a provision in a lease agreement that (i) prohibits the voluntary or involuntary transfer, including a transfer by sale, sublease, creation or enforcement of a security interest, or attachment, levy, or other judicial process, of an interest of a party under the lease contract or of the lessor's residual interest in the goods, or (ii) makes such a transfer an event of default, gives rise to the rights and remedies provided in subsection (4) of this section, but a transfer that is prohibited or is an event of default under the lease agreement is otherwise effective.

(3) A provision in a lease agreement that (i) prohibits a transfer of a right to damages for default with respect to the whole lease contract or of a right to payment arising out of the transferor's due performance of the transferor's entire obligation, or (ii) makes such a transfer an event of default, is not enforceable, and such a transfer is not a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract within the purview of subsection (4) of this section.

(4) Subject to subsection (3) of this section and section 4-9-407:

(a) If a transfer is made that is made an event of default under a lease agreement, the party to the lease contract not making the transfer, unless that party waives the default or otherwise agrees, has the rights and remedies described in section 4-2.5-501 (2);

(b) If paragraph (a) of this subsection (4) is not applicable and if a transfer is made that (i) is prohibited under a lease agreement or (ii) materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract, unless the party not making the transfer agrees at any time to the transfer in the lease contract or otherwise, then, except as limited by contract, (i) the transferor is liable to the party not making the transfer for damages caused by the transfer to the extent that the damages could not reasonably be prevented by the party not making the transfer and (ii) a court having jurisdiction may grant

other appropriate relief, including cancellation of the lease contract or an injunction against the transfer.

(5) A transfer of "the lease" or of "all my rights under the lease", or a transfer in similar general terms, is a transfer of rights and, unless the language or the circumstances, as in a transfer for security, indicate the contrary, the transfer is a delegation of duties by the transferor to the transferee. Acceptance by the transferee constitutes a promise by the transferee to perform those duties. The promise is enforceable by either the transferor or the other party to the lease contract.

(6) Unless otherwise agreed by the lessor and the lessee, a delegation of performance does not relieve the transferor as against the other party of any duty to perform or of any liability for default.

(7) In a consumer lease, to prohibit the transfer of an interest of a party under the lease contract or to make a transfer an event of default, the language must be specific, by a writing, and conspicuous.

Source: L. 91: Entire article added, p. 288, § 1, effective July 1, 1992. **L. 2001:** Entire section R&RE, p. 1439, § 24, effective July 1.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-210 and 9-311.

Changes: The provisions of Sections 2-210 and 9-311 were incorporated in this section, with substantial modifications to reflect leasing terminology and practice and to harmonize the principles of the respective provisions, i.e. limitations on delegation of performance on the one hand and alienability of rights on the other. In addition, unlike Section 2-210 which deals only with voluntary transfers, this section deals with involuntary as well as voluntary transfers. Moreover, the principle of Section 9-318(4) denying effectiveness to contractual terms prohibiting assignments of receivables due and to become due also is implemented.

Purposes:

1. Subsection (2) states a rule, consistent with Section 9-311, that voluntary and involuntary transfers of an interest of a party under the lease contract or of the lessor's residual interest, including by way of the creation or enforcement of a security interest, are effective, notwithstanding a provision in the lease agreement prohibiting the transfer or making the transfer an event of default. Although the transfers are effective, the provision in the lease agreement is nevertheless enforceable, but only as provided in subsection (5). Under subsection (5) the prejudiced party is limited to the remedies on "default under the lease contract" in this Article and, except as limited by this Article, as provided in the lease agreement, if the transfer has been made an event of default. Section 2A-501(2). Usually, there will be a specific provision to this effect or a general provision making a breach of a covenant an event of default. In those cases where the transfer is prohibited, but not made an event of default, the prejudiced party may recover damages; or, if the damage remedy would be ineffective adequately to protect that party, the court can order cancellation of the lease contract or enjoin the transfer. This rule that such provisions generally are enforceable is subject to subsections (3) and (4), which make such provisions unenforceable in certain instances.

2. The first such instance is described in subsection (3). A provision in a lease agreement which prohibits the creation or enforcement of a security interest, including sales of lease contracts subject to Article 9 (Sections 9-102(1)(b) and 9-104(f)), or makes it an event of default is generally not enforceable, reflecting the policy of Section 9-318(4). However, that policy gives way to the doctrine stated in Section 2-210(2), which gives one party to a contract the right to protect itself against an actual delegation (but not just a provision under which delegation might later occur) of a material performance by the other party. Accordingly, such a provision in a lease agreement is enforceable when the transfer delegates a material performance. Generally, as expressly provided in subsection (6), a transfer for security is not a delegation of duties. However, inasmuch as the creation of a security interest includes the sale of a lease contract, if there are then unperformed duties on the part of the lessor/seller, there could be a delegation of duties in the sale, and, if such a delegation actually takes place and is of a material performance, a provision in a lease agreement prohibiting it or making it an event of default would be enforceable, giving rise to the rights and remedies stated in subsection (5). The statute does not define "material." The parties may set standards to determine its meaning. The term is intended to exclude delegations of matters such as accounting to a professional accountant and the performance of, as opposed to the responsi-

bility for, maintenance duties to a person in the maintenance service industry.

3. For similar reasons, the lessor is entitled to protect its residual interest in the goods by prohibiting anyone but the lessee from possessing or using them. Accordingly, under subsection (3) if there is an actual transfer by the lessee of its right of possession or use of the goods in violation of a provision in the lease agreement, such a provision likewise is enforceable, giving rise to the rights and remedies stated in subsection (5). A transfer of the lessee's right of possession or use of the goods resulting from the enforcement of a security interest granted by the lessee in its leasehold interest is a "transfer by the lessee" under this subsection.

4. Finally, subsection (3) protects against a claim that the creation or enforcement of a security interest in the lessor's interest under the lease contract or in the residual interest is a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on the lessee so as to give rise to the rights and remedies stated in subsection (5), unless the transfer involves an actual delegation of a material performance of the lessor.

5. While it is not likely that a transfer by the lessor of its right to payment under the lease contract would impair at a future time the ability of the lessee to obtain the performance due the lessee under the lease contract from the lessor, if under the circumstances reasonable grounds for insecurity as to receiving that performance arise, the lessee may employ the provision of this Article for demanding adequate assurance of due performance and has the remedy provided in that circumstance. Section 2A-401.

6. Sections 9-206 and 9-318(1) through (3) also are relevant. Section 9-206 sanctions an agreement by a lessee not to assert certain types of claims or defenses against the lessor's assignee. Section 9-318(1) through (3) deal with, among other things, the other party's rights against the assignee where Section 9-206(1) does not apply. Since the definition of contract under Section 1-201(11) includes a lease agreement, the definition of account debtor under Section 9-105(1)(a) includes a lessee of goods. As a result, Section 9-206 applies to lease agreements, and there is no need to restate those sections in this Article. The reference to "defenses or claims arising out of a sale" in Section 9-318(1) should be interpreted broadly to include defenses or claims arising out of a lease inasmuch as that section codifies the common law rule with respect to contracts, including lease contracts.

7. Subsection (4) is based upon Section 2-210(2) and Section 9-318(4). It makes unenforceable a prohibition against transfers of certain rights to payment or a provision making the transfer an event of default. It also provides that such transfers do not materially impair the prospect of obtaining return performance by, materially change the duty of, or materially increase the burden or risk imposed on, the other party to the lease contract so as to give rise to the rights and remedies stated in subsection (5). Accordingly, a transfer of a right to payment cannot be prohibited or made an event of default, or be one that materially impairs performance, changes duties or increases risk, if the right is already due or will become due without further performance being required by the party to receive payment. Thus, a lessor can transfer the right to future payments under the lease contract, including by way of a grant of a security interest, and the transfer will not give rise to the rights and remedies stated in subsection (5) if the lessor has no remaining performance under the lease contract. The mere fact that the lessor is obligated to allow the lessee to remain in possession and to use the goods as long as the lessee is not in default does not mean that there is "remaining performance" on the part of the lessor. Likewise, the fact that the lessor has potential liability under a "non-operating" lease contract for breaches of warranty does not mean that there is "remaining performance." In contrast, the lessor would have "remaining performance" under a lease contract requiring the lessor to regularly maintain and service the goods or to provide "upgrades" of the equipment on a periodic basis in order to avoid obsolescence. The basic distinction is between a mere potential duty to respond which is not "remaining performance," and an affirmative duty to render stipulated performance. Although the distinction may be difficult to draw in some cases, it is instructive to focus on the difference between "operating" and "non-operating" leases as generally understood in the marketplace. Even if there is "remaining performance" under a lease contract, a transfer for security of a right to payment that is made an event of default or that is in violation of a prohibition against transfer does not give rise to the rights and remedies under subsection (5) if it does not constitute an actual delegation of a material performance under subsection (3).

8. The application of either the rule of subsection (3) or the rule of subsection (4) to the grant by the lessor of a security interest in the lessor's right to future payment under the lease contract may produce the same result. Both subsections generally protect security transfers by the lessor in particular because the creation by the lessor of a security interest or the enforcement of that interest generally will not prejudice the lessee's rights if it does not result in a delegation of the lessor's duties. To the contrary, the receipt of loan proceeds or relief from the enforcement of an antecedent debt normally should enhance the lessor's ability to perform its duties under the lease contract. Nevertheless,

there are circumstances where relief might be justified. For example, if ownership of the goods is transferred pursuant to enforcement of a security interest to a party whose ownership would prevent the lessee from continuing to possess the goods, relief might be warranted. See 49 U.S.C. § 1401(a) and (b) which places limitations on the operation of aircraft in the United States based on the citizenship or corporate qualification of the registrant.

9. Relief on the ground of material prejudice when the lease agreement does not prohibit the transfer or make it an event of default should be afforded only in extreme circumstances, considering the fact that the party asserting material prejudice did not insist upon a provision in the lease agreement that would protect against such a transfer.

10. Subsection (5) implements the rule of subsection (2). Subsection (2) provides that, even though a transfer is effective, a provision in the lease agreement prohibiting it or making it an event of default may be enforceable as provided in subsection (5). See Brummond v. First National Bank of Clovis, 656 P.2d 884, 35 U.C.C. Rep. Serv. (Callaghan) 1311 (N. Mex. 1983), stating the analogous rule for Section 9-311. If the transfer prohibited by the lease agreement is made an event of default, then, under subsection 5(a), unless the default is waived or there is an agreement otherwise, the aggrieved party has the rights and remedies referred to in Section 2A-501(2), viz. those in this Article and, except as limited in the Article, those provided in the lease agreement. In the unlikely circumstance that the lease agreement prohibits the transfer without making a violation of the prohibition an event of default or, even if there is no prohibition against the transfer, and the transfer is one that materially impairs performance, changes duties, or increases risk (for example, a sublease or assignment to a party using the goods improperly or for an illegal purpose), then subsection 5(b) is applicable. In that circumstance, unless the party aggrieved by the transfer has otherwise agreed in the lease contract, such as by assenting to a particular transfer or to transfers in general, or agrees in some other manner, the aggrieved party has the right to recover damages from the transferor and a court may, in appropriate circumstances, grant other relief, such as cancellation of the lease contract or an injunction against the transfer.

11. If a transfer gives rise to the rights and remedies provided in subsection (5), the transferee as an alternative may propose, and the other party may accept, adequate cure or compensation for past defaults and adequate assurance of future due performance under the lease contract. Subsection (5) does not preclude any other relief that may be available to a party to the lease contract aggrieved by a transfer subject to an enforceable prohibition, such as an action for interference with contractual relations.

12. Subsection (8) requires that a provision in a consumer lease prohibiting a transfer, or making it an event of default, must be specific, written and conspicuous. See Section 1-201(10). This assists in protecting a consumer lessee against surprise assertions of default.

13. Subsection (6) is taken almost verbatim from the provisions of Section 2-210(4). The subsection states a rule of construction that distinguishes a commercial assignment, which substitutes the assignee for the assignor as to rights and duties, and an assignment for security or financing assignment, which substitutes the assignee for the assignor only as to rights. Note that the assignment for security or financing assignment is a subset of all security interests. Security interest is defined to include "any interest of a buyer of ... chattel paper". Section 1-201(37). Chattel paper is defined to include a lease. Section 9-105(1)(b). Thus, a buyer of leases is the holder of a security interest in the leases. That conclusion should not influence this issue, as the policy is quite different. Whether a buyer of leases is the holder of a commercial assignment, or an assignment for security or financing assignment should be determined by the language of the assignment or the circumstances of the assignment.

Cross References:

Sections 1-201(11), 1-201(37), 2-210, 2-609 2A-401, 9-102(1)(b), 9-104(f), 9-105(1)(a), 9-206, and 9-318.

Definitional Cross References:

"Agreed" and "Agreement". Section 1-201(3).

"Conspicuous". Section 1-201(10).

"Goods". Section 2A-103(1)(h).

"Lease". Section 2A-103(1)(j).

"Lease contract". Section 2A-103(1)(l).

"Lessee". Section 2A-103(1)(n).

"Lessor". Section 2A-103(1)(p).

"Lessor's residual interest". Section 2A-103(1)(q).

"Notice". Section 1-201(25).

"Party". Section 1-201(29).

"Person". Section 1-201(30).

"Reasonable time". Section 1-204(1) and (2).

"Rights". Section 1-201(36).

"Term". Section 1-201(42).

"Writing". Section 1-201(46).

4-2.5-304. Subsequent lease of goods by lessor. (1) Subject to section 4-2.5-303, a subsequent lessee from a lessor of goods under an existing lease contract obtains, to the extent of the leasehold interest transferred, the leasehold interest in the goods that the lessor had or had power to transfer, and except as provided in subsection (2) of this section and

section 4-2.5-527 (4), takes subject to the existing lease contract. A lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value, but only to the extent set forth in the preceding sentence. If goods have been delivered under a transaction of purchase, the lessor has that power even though:

(a) The lessor's transferor was deceived as to the identity of the lessor;

(b) The delivery was in exchange for a check which is later dishonored;

(c) It was agreed that the transaction was to be a "cash sale"; or

(d) The delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A subsequent lessee in the ordinary course of business from a lessor who is a merchant dealing in goods of that kind to whom the goods were entrusted by the existing lessee of that lessor before the interest of the subsequent lessee became enforceable against that lessor obtains, to the extent of the leasehold interest transferred, all of that lessor's and the existing lessee's rights to the goods, and takes free of the existing lease contract.

(3) A subsequent lessee from the lessor of goods that are subject to an existing lease contract and are covered by a certificate of title issued under a statute of this state or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute.

Source: L. 91: Entire article added, p. 290, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403.

Changes: While Section 2-403 was used as a model for this section, the provisions of Section 2-403 were significantly revised to reflect leasing practices and to integrate this Article with certificate of title statutes.

Purposes:

1. This section must be read in conjunction with, as it is subject to, the provisions of Section 2A-303, which govern voluntary and involuntary transfers of rights and duties under a lease contract, including the lessor's residual interest in the goods.

2. This section must also be read in conjunction with Section 2-403. This section and Section 2A-305 are derived from Section 2-403, which states a unified policy on good faith purchases of goods. Given the scope of the definition of purchaser (Section 1-201(33)), a person who bought goods to lease as well as a person who bought goods subject to an existing lease from a lessor will take pursuant to Section 2-403. Further, a person who leases such goods from the person who bought them should also be protected under Section 2-403, first because the lessee's rights are derivative and second because the definition of purchaser should be interpreted to include one who takes by lease; no negative implication should be drawn from the inclusion of lease in the definition of purchase in this Article. Section 2A-103(1)(v).

3. There are hypotheticals that relate to an entrustee's unauthorized lease of entrusted goods to a third party that are outside the provisions of Sections 2-403, 2A-304 and 2A-305. Consider a sale of goods by M, a merchant, to B, a buyer. After paying for the goods B allows M to retain possession of the goods as B is short of storage. Before B calls for the goods M leases the goods to L, a lessee. This transaction is not governed by Section 2-403(2) as L is not a buyer in the ordinary course of business. Section 1-201(9). Further, this transaction is not governed by Section 2A-304(2) as B is not an existing lessee. Finally, this transaction is not governed by Section 2A-305(2) as B is not M's lessor. Section 2A-307(2) resolves the potential dispute between B, M and L. By virtue of B's entrustment of the goods to M and M's lease of the goods to L, B has a cause of action against M under the common law. Sections 2A-103(4) and 1-103. See, e.g., Restatement (Second) of Torts §§ 222A-243. Thus, B is a creditor of M. Sections 2A-103(4) and 1-201(12). Section 2A-307(2) provides that B, as M's creditor, takes subject to M's lease to L. Thus, if L does not default under the lease, L's enjoyment and possession of the goods should be undisturbed. However, B is not without recourse. B's action should result in a judgment against M providing, among other things, a turnover of all proceeds arising from M's lease to L, as well as a transfer of all of M's right, title and interest as lessor under M's lease to L, including M's residual interest in the goods. Section 2A-103(1)(q).

4. Subsection (1) states a rule with respect to the leasehold interest obtained by a subsequent lessee from a lessor of goods under an existing lease contract. The interest will include such leasehold interest as the lessor has in the goods as well as the leasehold interest that the lessor had the power to transfer. Thus, the subsequent lessee obtains unimpaired all rights acquired under the law of agency, apparent

agency, ownership or other estoppel, whether based upon statutory provisions or upon case law principles. Sections 2A-103(4) and 1-103. In general, the subsequent lessee takes subject to the existing lease contract, including the existing lessee's rights thereunder. Furthermore, the subsequent lease contract is, of course, limited by its own terms, and the subsequent lessee takes only to the extent of the leasehold interest transferred thereunder.

5. Subsection (1) further provides that a lessor with voidable title has power to transfer a good leasehold interest to a good faith subsequent lessee for value. In addition, subsections (1)(a) through (d) provide specifically for the protection of the good faith subsequent lessee for value in a number of specific situations which have been troublesome under prior law.

6. The position of an existing lessee who entrusts leased goods to its lessor is not distinguishable from the position of other entrusters. Thus, subsection (2) provides that the subsequent lessee in the ordinary course of business takes free of the existing lease contract between the lessor entrustee and the lessee entruster, if the lessor is a merchant dealing in goods of that kind. Further, the subsequent lessee obtains all of the lessor entrustee's and the lessee entruster's rights to the goods, but only to the extent of the leasehold interest transferred by the lessor entrustee. Thus, the lessor entrustee retains the residual interest in the goods. Section 2A-103(1)(q). However, entrustment by the existing lessee must have occurred before the interest of the subsequent lessee became enforceable against the lessor. Entrusting is defined in Section 2-403(3) and that definition applies here. Section 2A-103(3).

7. Subsection (3) states a rule with respect to a transfer of goods from a lessor to a subsequent lessee where the goods are subject to an existing lease and covered by a certificate of title. The subsequent lessee's rights are no greater than those provided by this section and the applicable certificate of title statute, including any applicable case law construing such statute. Where the relationship between the certificate of title statute and Section 2-403, the statutory analogue to this section, has been construed by a court, that construction is incorporated here. Sections 2A-103(4) and 1-102(1) and (2). The better rule is that the certificate of title statutes are in harmony with Section 2-403 and thus would be in harmony with this section. E.g., Atwood Chevrolet-Olds v. Aberdeen Mun. School Dist., 431 So.2d 926, 928 (Miss. 1983); Godfrey v. Gilsdorf, 476 P.2d 3, 6, 86 Nev. 714, 718 (1970); Martin v. Nager, 192 N.J. Super. 189, 197-98, 469 A.2d 519, 523 (Super. Ct. Ch. Div. 1983). Where the certificate of title statute is silent on this issue of transfer, this section will control.

Cross References:

Sections 1-102, 1-103, 1-201(33), 2-403, 2A-103(1)(v), 2A-103(3), 2A-103(4), 2A-303 and 2A-305.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Delivery". Section 1-201(14).
"Entrusting". Section 2-403(3).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Leasehold interest". Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Purchase". Section 2A-103(1)(v).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

4-2.5-305. Sale or sublease of goods by lessee. (1) Subject to the provisions of section 4-2.5-303, a person claiming as a buyer or sublessee of goods under an existing lease contract obtains, to the extent of the interest transferred, the leasehold interest in the goods that the transferor to that person had or had power to transfer, and except as provided in subsection (2) of this section and section 4-2.5-511 (4), takes subject to the existing lease contract. A lessee with a voidable leasehold interest has power to transfer a good leasehold interest to a good faith buyer for value or a good faith sublessee for value, but only to the extent set forth in the preceding sentence. When goods have been delivered under a transaction of lease the lessee has that power even though:

(a) The lessor was deceived as to the identity of the lessee;

(b) The delivery was in exchange for a check which is later dishonored; or

(c) The delivery was procured through fraud punishable as larcenous under the criminal law.

(2) A buyer in the ordinary course of business or a sublessee in the ordinary course of business from a lessee who is a merchant dealing in goods of that kind to whom the goods were entrusted by the lessor obtains, to the extent of the interest transferred, all of the lessor's and lessee's rights to the goods, and takes free of the existing lease contract.

(3) A buyer or sublessee from the lessee of goods that are subject to an existing lease

contract and are covered by a certificate of title issued under a statute of this state or of another jurisdiction takes no greater rights than those provided both by this section and by the certificate of title statute.

Source: L. 91: Entire article added, p. 291, § 1, effective July 1, 1992.

Editor's note - Colorado legislative change: In the first sentence of subsection (1) of this section, Colorado made the following changes: 1) After the reference to "section 4-2.5-303,", inserted the words "a person claiming as"; 2) After the word "sublessee", deleted the words "from the lessee"; and 3) After the words "goods that the", deleted the word "lessee" and substituted the words "transferor to that person".

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-403.

Changes: While Section 2-403 was used as a model for this section, the provisions of Section 2-403 were significantly revised to reflect leasing practice and to integrate this Article with certificate of title statutes.

Purposes:

This section, a companion to Section 2A-304, states the rule with respect to the leasehold interest obtained by a buyer or sublessee from a lessee of goods under an existing lease contract. Cf. Section 2A-304 official comment. Note that this provision is consistent with existing case law, which prohibits the bailee's transfer of title to a good faith purchaser for value under Section 2-403(1). Rohweder v. Aberdeen Product. Credit Ass'n, 765 F.2d 109 (8th Cir. 1985).

Subsection (2) is also consistent with existing case law. American Standard Credit, Inc. v. National Cement Co., 643 F.2d 248, 269-70 (5th Cir. 1981); but cf. Exxon Co., U.S.A. v. TLW Computer Indus., 37 U.C.C. Rep. Serv. (Callaghan) 1052, 1057-58 (D. Mass. 1983). Unlike Section 2A-304(2), this subsection does not contain any requirement with respect to the time that the goods were entrusted to the merchant. In Section 2A-304(2) the competition is between two customers of the merchant lessor; the time of entrusting was added as a criterion to create additional protection to the customer who was first in time: the existing lessee. In subsection (2) the equities between the competing interests were viewed as balanced.

There appears to be some overlap between Section 2-403(2) and Section 2A-305(2) with respect to a buyer in the ordinary course of business. However, an examination of this Article's definition of buyer in the ordinary course of business (Section 2A-103(1)(a)) makes clear that this reference was necessary to treat entrusting in the context of a lease.

Subsection (3) states a rule of construction with respect to a transfer of goods from a lessee to a buyer or sublessee, where the goods are subject to an existing lease and covered by a certificate of title. Cf. Section 2A-304 official comment.

Cross References:

Sections 2-403, 2A-103(1)(a), 2A-304 and 2A-305(2).

Definitional Cross References:

"Buyer". Section 2-103(1)(a).
"Buyer in the ordinary course of business". Section 2A-103(1)(a).
"Delivery". Section 1-201(14).
"Entrusting". Section 2-403(3).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Leasehold interest." Section 2A-103(1)(m).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Merchant". Section 2-104(1).
"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Sublease". Section 2A-103(1)(w).
"Value". Section 1-201(44).

4-2.5-306. Priority of certain liens arising by operation of law. If a person in the ordinary course of his [or her] business furnishes services or materials with respect to goods subject to a lease contract, a lien upon those goods in the possession of that person given by statute or rule of law for those materials or services takes priority over any interest arising under the lease contract or this article of the party to the lease contract at whose instance the services or materials were furnished, but does not take priority over any such interest of the other party to the lease contract unless the lien is created by statute and the statute provides otherwise or unless the lien is created by rule of law and the rule of law provides otherwise.

Source: L. 91: Entire article added, p. 292, § 1, effective July 1, 1992.

Editor's note - Colorado legislative change: After the word "interest", Colorado deleted the words "of the lessor or lessee under the lease contract or this article" and substituted the words "arising under the lease contract or this article of the party to the lease contract at whose instance the services or materials were furnished, but does not take priority over any such interest of the other party to the lease contract".

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-310.
Changes: The approach reflected in the provisions of Section 9-310 was included, but revised to conform to leasing terminology and to expand the exception to the special priority granted to protected liens to cover liens created by rule of law as well as those created by statute.
Purposes: This section should be interpreted to allow a qualified lessor or a qualified lessee to be the competing lienholder if the statute or rule of law so provides. The reference to statute includes applicable regulations and cases; these sources must be reviewed in resolving a priority dispute under this section.
Cross Reference:
Section 9-310.
Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lease Contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Person". Section 1-201(30).

4-2.5-307. Priority of liens arising by attachment or levy on, security interests in, and other claims to goods. (1) Except as otherwise provided in section 4-2.5-306, a creditor of a lessee takes subject to the lease contract.

(2) Except as otherwise provided in subsection (3) of this section and in sections 4-2.5-306 and 4-2.5-308, a creditor of a lessor takes subject to the lease contract unless the creditor holds a lien that attached to the goods before the lease contract became enforceable.

(3) Except as otherwise provided in sections 4-9-317, 4-9-321, and 4-9-323, a lessee takes a leasehold interest subject to a security interest held by a creditor of the lessor.

Source: L. 91: Entire article added, p. 292, § 1, effective July 1, 1992. **L. 2001:** Entire section R&RE, p. 1440, § 25, effective July 1.

OFFICIAL COMMENT

Uniform Statutory Source: None for subsection (1). Subsection (2) is derived from Section 9-301, and subsections (3) and (4) are derived from Section 9-307(1) and (3), respectively.
Changes: The provisions of Sections 9-301 and 9-307(1) and (3) were incorporated, and modified to reflect leasing terminology and the basic concepts reflected in this Article.
Purposes:

1. Subsection (1) states a general rule of priority that a creditor of the lessee takes subject to the lease contract. The term lessee (Section 2A-103(1)(n)) includes sublessee. Therefore, this subsection not only covers disputes between the prime lessor and a creditor of the prime lessee but also disputes between the prime lessor, or the sublessor, and a creditor of the sublessee. Section 2A-301 official comment 3(g). Further, by using the term creditor (Section 1-201(12)), this subsection will cover disputes with a general creditor, a secured creditor, a lien creditor and any representative of creditors. Section 2A-103(4).

2. Subsection (2) states a general rule of priority that a creditor of a lessor takes subject to the lease contract. Note the discussion above with regard to the scope of these rules. Section 2A-301 official comment 3(g). Thus, the section will not only cover disputes between the prime lessee and a creditor of the prime lessor but also disputes between the prime lessee, or the sublessee, and a creditor of the sublessor.

3. To take priority over the lease contract, and the interests derived therefrom, the creditor must come within one of three exceptions stated within the rule. First, subsection (2)(a) provides that where the creditor holds a lien (Section 2A-103(1)(r)) that attached before the lease contract became enforceable (Section 2A-301), the creditor does not take subject to the lease. Second, subsection (2)(b) provides that when the creditor holds a security interest (Section 1-201(37)), whether or not perfected, the creditor has priority over a lessee who did not give value (Section 1-201(44)) and receive delivery of the goods without knowledge (Section

1-201(25)) of the security interest. As to other lessees, under subsection (2)(c) a secured creditor holding a perfected security interest before the time the lease contract became enforceable (Section 2A-301) does not take subject to the lease. With respect to this provision, the lessee in these circumstances is treated like a buyer so that perfection of a purchase money security interest does not relate back (Section 9-301).

4. The rules of this section operate in favor of whichever party to the lease contract may enforce it, even if one party perhaps may not, e.g., under Section 2A-201(1)(b).

5. The rules stated in subsections (2)(b) and (c), and the rule in subsection (3), are best understood by reviewing a hypothetical. Assume that a merchant engaged in the business of selling and leasing musical instruments obtained possession of a truck load of musical instruments on deferred payment terms from a supplier of musical instruments on January 6. To secure payment of such credit the merchant granted the supplier a security interest in the instruments; the security interest was perfected by filing on January 15. The merchant, as lessor, entered into a lease to an individual of one of the musical instruments supplied by the supplier; the lease became enforceable on January 10. Under subsection (2)(b) the lessee will prevail (assuming the lessee qualifies thereunder) unless subsection (c) provides otherwise. Under the rule stated in subsection (2)(c) a priority dispute between the supplier, as the lessor's secured creditor, and the lessee would be determined by ascertaining on January 10 (the day the lease became enforceable) the validity and perfected status of the security interest in the musical instrument and the enforceability of the lease contract by the lessee. Nothing more appearing, under the rule stated in subsection (2)(c), the supplier's security interest in the musical instrument would not have priority over the lease contract. Moreover, subsection (2) states that its rules are subject to the rules of subsections (3) and (4). Under this hypothetical the lessee should qualify as a "lessee in the ordinary course of business". Section 2A-103(1)(o). Subsection (3) also makes clear that the lessee in the ordinary course of business will win even if he or she knows of the existence of the supplier's security interest.

6. Subsections (3) and (4), which are modeled on the provisions of Section 9-307(1) and (3), respectively, state two exceptions to the priority rule stated in subsection (2) with respect to a creditor who holds a security interest. The lessee in the ordinary course of business will be treated in the same fashion as the buyer in the ordinary course of business, given a priority dispute with a secured creditor over goods subject to a lease contract.

Cross References:

Sections 1-201(12), 1-201(25), 1-201(37), 1-201(44), 2A-103(1)(n), 2A-103(1)(o), 2A-103(1)(r), 2A-103(4), 2A-201(1)(b), 2A-301 official comment 3(g), Article 9, especially Sections 9-301, 9-307(1), and 9-307(3).

Definitional Cross References:

"Creditor". Section 1-201(12).

"Goods". Section 2A-103(1)(h).

"Knowledge" and "Knows". Section 1-201(25).

"Lease". Section 2A-103(1)(j).

"Lease contract". Section 2A-103(1)(l).

"Leasehold interest". Section 2A-103(1)(m).

"Lessee". Section 2A-103(1)(n).

"Lessee in the ordinary course of business". Section 2A-103(1)(o).

"Lessor". Section 2A-103(1)(p).

"Lien". Section 2A-103(1)(r).

"Party". Section 1-201(29).

"Pursuant to commitment". Section 2A-103(3).

"Security interest". Section 1-201(37).

4-2.5-308. Special rights of creditors. (1) A creditor of a lessor in possession of goods subject to a lease contract may treat the lease contract as void if as against the creditor retention of possession by the lessor is fraudulent under any statute or rule of law, but retention of possession in good faith and current course of trade by the lessor for a commercially reasonable time after the lease contract becomes enforceable is not fraudulent.

(2) Nothing in this article impairs the rights of creditors of a lessor if the lease contract (a) becomes enforceable, not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security, or the like, and (b) is made under circumstances which under any statute or rule of law apart from this article would constitute the transaction a fraudulent transfer or voidable preference.

(3) A creditor of a seller may treat a sale or an identification of goods to a contract for sale as void if as against the creditor retention of possession by the seller is fraudulent under any statute or rule of law, but retention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith.

Source: L. 91: Entire article added, p. 293, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-402(2) and (3)(b).

Changes: Rephrased and new material added to conform to leasing terminology and practice.

Purposes:

Subsection (1) states a general rule of avoidance where the lessor has retained possession of goods if such retention is fraudulent under any statute or rule of law. However, the subsection creates an exception under certain circumstances for retention of possession of goods for a commercially reasonable time after the lease contract becomes enforceable.

Subsection (2) also preserves the possibility of an attack on the lease by creditors of the lessor if the lease was made in satisfaction of or as security for a pre-existing claim, and would constitute a fraudulent transfer or voidable preference under other law.

Finally, subsection (3) states a new rule with respect to sale-leaseback transactions, i.e., transactions where the seller sells goods to a buyer but possession of the goods is retained by the seller pursuant to a lease contract between the buyer as lessor and the seller as lessee. Notwithstanding any statute or rule of law that would treat such retention as fraud, whether per se, prima facie, or otherwise, the retention is not fraudulent if the buyer bought for value (Section 1-201(44)) and in good faith (Sections 1-201(19) and 2-103(1)(b)). Section 2A-103(3) and (4). This provision overrides Section 2-402(2) to the extent it would otherwise apply to a sale-leaseback transaction.

Cross References:

Sections 1-201(19), 1-201(44), 2-402(2) and 2A- 103(4).

Definitional Cross References:

"Buyer". Section 2-103(1)(a).
"Contract". Section 1-201(11).
"Creditor". Section 1-201(12).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Money". Section 1-201(24).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Seller". Section 2-103(1)(d).
"Value". Section 1-201(44).

4-2.5-309. Lessor's and lessee's rights when goods become fixtures. (1) In this section:

(a) Goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law;

(b) A "fixture filing" is the filing, in the office where a record of a mortgage on the real estate would be filed or recorded, of a financing statement covering goods that are or are to become fixtures and conforming to the requirements of section 4-9-502 (a) and (b);

(c) A lease is a "purchase money lease" unless the lessee has possession or use of the goods or the right to possession or use of the goods before the lease agreement is enforceable;

(d) A mortgage is a "construction mortgage" to the extent it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates; and

(e) "Encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests.

(2) Under this article a lease may be of goods that are fixtures or may continue in goods that become fixtures, but no lease exists under this article of ordinary building materials incorporated into an improvement on land.

(3) This article does not prevent creation of a lease of fixtures pursuant to real estate law.

(4) The perfected interest of a lessor of fixtures has priority over a conflicting interest of an encumbrancer or owner of the real estate if:

(a) The lease is a purchase money lease, the conflicting interest of the encumbrancer or owner arises before the goods become fixtures, the interest of the lessor is perfected by a fixture filing before the goods become fixtures or within ten days thereafter, and the lessee has an interest of record in the real estate or is in possession of the real estate; or

(b) The interest of the lessor is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the lessor's interest has priority over any conflicting

interest of a predecessor in title of the encumbrancer or owner, and the lessee has an interest of record in the real estate or is in possession of the real estate.

(5) The interest of a lessor of fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate if:

(a) The fixtures are readily removable factory or office machines, readily removable equipment that is not primarily used or leased for use in the operation of the real estate, or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures the lease contract is enforceable; or

(b) The conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the lease contract is enforceable; or

(c) The encumbrancer or owner has consented in writing to the lease or has disclaimed an interest in the goods as fixtures; or

(d) The lessee has a right to remove the goods as against the encumbrancer or owner. If the lessee's right to remove terminates, the priority of the interest of the lessor continues for a reasonable time.

(6) Notwithstanding subsection (4) (a) of this section but otherwise subject to subsections (4) and (5) of this section, the interest of a lessor of fixtures, including the lessor's residual interest, is subordinate to the conflicting interest of an encumbrancer of the real estate under a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent given to refinance a construction mortgage, the conflicting interest of an encumbrancer of the real estate under a mortgage has this priority to the same extent as the encumbrancer of the real estate under the construction mortgage.

(7) In cases not within the preceding subsections, priority between the interest of a lessor of fixtures, including the lessor's residual interest, and the conflicting interest of an encumbrancer or owner of the real estate who is not the lessee is determined by the priority rules governing conflicting interests in real estate.

(8) If the interest of a lessor of fixtures, including the lessor's residual interest, has priority over all conflicting interests of all owners and encumbrancers of the real estate, the lessor or the lessee may (i) on default, expiration, termination, or cancellation of the lease agreement but subject to the lease agreement and this article, or (ii) if necessary to enforce other rights and remedies of the lessor or lessee under this article, remove the goods from the real estate, free and clear of all conflicting interests of all owners and encumbrancers of the real estate, but the lessor or lessee must reimburse any encumbrancer or owner of the real estate who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury, but not for any diminution in value of the real estate caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

(9) Even though the lease agreement does not create a security interest, the interest of a lessor of fixtures, including the lessor's residual interest, is perfected by filing a financing statement as a fixture filing for leased goods that are or are to become fixtures in accordance with the relevant provisions of the article on secured transactions, article 9 of this title.

Source: L. 91: Entire article added, p. 293, § 1, effective July 1, 1992. **L. 2001:** (1)(b) amended, p. 1441, § 26, effective July 1.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-313.
Changes: Revised to reflect leasing terminology and to add new material.
Purposes:

1. While Section 9-313 provided a model for this section, certain provisions were substantially revised.

2. Section 2A-309(1)(c), which is new, defines purchase money lease to exclude leases where the lessee had possession or use of the goods or the right thereof before the lease agreement became enforceable. This term is used in subsection (4)(a) as one of the conditions that must be satisfied to obtain priority over the conflicting interest of an encumbrancer or owner of the real estate.

3. Section 2A-309(4), which states one of several priority rules found in this section, de-

letes reference to office machines and the like (Section 9-313(4)(c)) as well as certain liens (Section 9-313(4)(d)). However, these items are included in subsection (5), another priority rule that is more permissive than the rule found in subsection (4) as it applies whether or not the interest of the lessor is perfected. In addition, subsection (5)(a) expands the scope of the provisions of Section 9-313(4)(c) to include readily removable equipment not primarily used or leased for use in the operation of real estate; the qualifier is intended to exclude from the expanded rule equipment integral to the operation of real estate, e.g., heating and air conditioning equipment.

4. The rule stated in subsection (7) is more liberal than the rule stated in Section 9-313(7) in that issues of priority not otherwise resolved in this subsection are left for resolution by the priority rules governing conflicting interests in real estate, as opposed to the Section 9-313(7) automatic subordination of the security interest in fixtures. Note that, for the purpose of this section, where the interest of an encumbrancer or owner of the real estate is paramount to the interest of the lessor, the latter term includes the residual interest of the lessor.

5. The rule stated in subsection (8) is more liberal than the rule stated in Section 9-313(8) in that the right of removal is extended to both the lessor and the lessee and the occasion for removal includes expiration, termination or cancellation of the lease agreement, and enforcement of rights and remedies under this Article, as well as default. The new language also provides that upon removal the goods are free and clear of conflicting interests of owners and encumbrancers of the real estate.

6. Finally, subsection (9) provides a mechanism for the lessor of fixtures to perfect its interest by filing a financing statement under the provisions of the Article on Secured Transactions (Article 9), even though the lease agreement does not create a security interest. Section 1-201(37). The relevant provisions of Article 9 must be interpreted permissively to give effect to this mechanism as it implicitly expands the scope of Article 9 so that its filing provisions apply to transactions that create a lease of fixtures, even though the lease agreement does not create a security interest. This mechanism is similar to that provided in Section 2-326(3)(c) for the seller of goods on consignment, even though the consignment is not "intended as security". Section 1-201(37). Given the lack of litigation with respect to the mechanism created for consignment sales, this new mechanism should prove effective.

Cross References:

Sections 1-201(37), 2A-309(1)(c), 2A-309(4), Article 9, especially Sections 9-313, 9-313(4)(c), 9-313(4)(d), 9-313(7), 9-313(8) and 9-408.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Cancellation". Section 2A-103(1)(b).
"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A-103(1)(e).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lien". Section 2A-103(1)(r).
"Mortgage". Section 9-105(1)(j).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Writing". Section 1-201(46).

4-2.5-310. Lessor's and lessee's rights when goods become accessions. (1) Goods are "accessions" when they are installed in or affixed to other goods.

(2) The interest of a lessor or a lessee under a lease contract entered into before the goods became accessions is superior to all interests in the whole except as stated in subsection (4) of this section.

(3) The interest of a lessor or a lessee under a lease contract entered into at the time or after the goods became accessions is superior to all subsequently acquired interests in the whole except as stated in subsection (4) of this section but is subordinate to interests in the whole existing at the time the lease contract was made unless the holders of such interests in the whole have in writing consented to the lease or disclaimed an interest in the goods as part of the whole.

(4) The interest of a lessor or a lessee under a lease contract described in subsection (2) or (3) of this section is subordinate to the interest of:

(a) A buyer in the ordinary course of business or a lessee in the ordinary course of business of any interest in the whole acquired after the goods became accessions; or

(b) A creditor with a security interest in the whole perfected before the lease contract was made to the extent that the creditor makes subsequent advances without knowledge of the lease contract.

(5) When under subsections (2) or (3) and (4) of this section a lessor or a lessee of accessions holds an interest that is superior to all interests in the whole, the lessor or the lessee may (a) on default, expiration, termination, or cancellation of the lease contract by the other party but subject to the provisions of the lease contract and this article, or (b) if necessary to enforce his or her other rights and remedies under this article, remove the goods from the whole, free and clear of all interests in the whole, but he or she must reimburse any holder of an interest in the whole who is not the lessee and who has not otherwise agreed for the cost of repair of any physical injury but not for any diminution in value of the whole caused by the absence of the goods removed or by any necessity for replacing them. A person entitled to reimbursement may refuse permission to remove until the party seeking removal gives adequate security for the performance of this obligation.

Source: L. 91: Entire article added, p. 296, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-314.
Changes: Revised to reflect leasing terminology and to add new material.
Purposes:
Subsections (1) and (2) restate the provisions of subsection (1) of Section 9-314 to clarify the definition of accession and to add leasing terminology to the priority rule that applies when the lease is entered into before the goods become accessions. Subsection (3) restates the provisions of subsection (2) of Section 9-314 to add leasing terminology to the priority rule that applies when the lease is entered into on or after the goods become accessions. Unlike the rule with respect to security interests, the lease is merely subordinate, not invalid.

Subsection (4) creates two exceptions to the priority rules stated in subsections (2) and (3). Subsection (4) deletes the special priority rule found in the provisions of Section 9-314(3)(b) as the interests of the lessor and lessee are entitled to greater protection.

Finally, subsection (5) is modeled on the provisions of Section 9-314(4) with respect to removal of accessions, restated to reflect the parallel changes in Section 2A-309(8).

Neither this section nor Section 9-314 governs where the accession to the goods is not subject to the interest of a lessor or a lessee under a lease contract and is not subject to the interest of a secured party under a security agreement. This issue is to be resolved by the courts, case by case.

Cross References:
Sections 2A-309(8), 9-314(1), 9-314(2), 9-314(3)(b), 9-314(4).

Definitional Cross References:
"Agreed". Section 1-201(3).
"Buyer in the ordinary course of business". Section 2A-103(1)(a).
"Cancellation". Section 2A-103(1)(b).
"Creditor". Section 1-201(12).
"Goods". Section 2A-103(1)(h).
"Holder". Section 1-201(20).
"Knowledge". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessee in the ordinary course of business". Section 2A-103(1)(o).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Writing". Section 1-201(46).

4-2.5-311. Priority subject to subordination. Nothing in this article prevents subordination by agreement by any person entitled to priority.

Source: L. 91: Entire article added, p. 297, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-316.
Purposes: The several preceding sections deal with questions of priority. This section is inserted to make it entirely clear that a person entitled to priority may effectively agree to subordinate the claim. Only the person entitled to

priority may make such an agreement: the rights of such a person cannot be adversely affected by an agreement to which that person is not a party.
Cross References:
Sections 1-102 and 2A-304 through 2A-310.

Definitional Cross References:
"Agreement". Section 1-201(3).
"Person". Section 1-201(30).

PART 4

PERFORMANCE OF LEASE CONTRACT: REPUDIATED, SUBSTITUTED AND EXCUSED

4-2.5-401. Insecurity: Adequate assurance of performance. (1) A lease contract imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.

(2) If reasonable grounds for insecurity arise with respect to the performance of either party, the insecure party may demand in writing adequate assurance of due performance. Until the insecure party receives that assurance, if commercially reasonable the insecure party may suspend any performance for which he or she has not already received the agreed return.

(3) A repudiation of the lease contract occurs if assurance of due performance adequate under the circumstances of the particular case is not provided to the insecure party within a reasonable time, not to exceed thirty days after receipt of a demand by the other party.

(4) Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered must be determined according to commercial standards.

(5) Acceptance of any nonconforming delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

Source: L. 91: Entire article added, p. 297, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-609.
Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (3) (Section 2-609(4)), the adjective "justified" modifies demand. The adjective was deleted here as unnecessary, implying no substantive change.
Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Agreed". Section 1-201(3).
"Between merchants". Section 2-104(3).
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Writing". Section 1-201(46).

4-2.5-402. Anticipatory repudiation. If either party repudiates a lease contract with respect to a performance not yet due under the lease contract, the loss of which performance will substantially impair the value of the lease contract to the other, the aggrieved party may:

(a) For a commercially reasonable time, await retraction of repudiation and performance by the repudiating party;

(b) Make demand pursuant to section 4-2.5-401 and await assurance of future performance adequate under the circumstances of the particular case; or

(c) Resort to any right or remedy upon default under the lease contract or this article, even though the aggrieved party has notified the repudiating party that the aggrieved party would await the repudiating party's performance and assurance and has urged retraction. In addition, whether or not the aggrieved party is pursuing one of the foregoing remedies, the aggrieved party may suspend performance or, if the aggrieved party is the lessor, proceed in accordance with the provisions of this article on the lessor's right to identify goods to the lease contract notwithstanding default or to salvage unfinished goods (section 4-2.5-524).

Source: L. 91: Entire article added, p. 297, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-610.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

4-2.5-403. Retraction of anticipatory repudiation. (1) Until the repudiating party's next performance is due, the repudiating party can retract the repudiation unless, since the repudiation, the aggrieved party has cancelled the lease contract or materially changed the aggrieved party's position or otherwise indicated that the aggrieved party considers the repudiation final.

(2) Retraction may be by any method that clearly indicates to the aggrieved party that the repudiating party intends to perform under the lease contract and includes any assurance demanded under section 4-2.5-401.

(3) Retraction reinstates a repudiating party's rights under a lease contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

Source: L. 91: Entire article added, p. 298, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-611.
Changes: Revised to reflect leasing practices and terminology. Note that in the analogue to subsection (2) (Section 2-611(2)) the adjective "justifiably" modifies demanded. The adjective was deleted here (as it was in Section 2A-401) as unnecessary, implying no substantive change.
Definitional Cross References:
"Aggrieved party". Section 1-201(2).
"Cancellation". Section 2A-103(1)(b).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).

4-2.5-404. Substituted performance. (1) If without fault of the lessee, the lessor and the supplier, the agreed berthing, loading, or unloading facilities fail or the agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable, but a commercially reasonable substitute is available, the substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation:

(a) The lessor may withhold or stop delivery or cause the supplier to withhold or stop delivery unless the lessee provides a means or manner of payment that is commercially a substantial equivalent; and

(b) If delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the lessee's obligation unless the regulation is discriminatory, oppressive, or predatory.

Source: L. 91: Entire article added, p. 298, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-614.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Agreed". Section 1-201(3).
"Delivery". Section 1-201(14).

"Fault". Section 2A-103(1)(f).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Supplier". Section 2A-103(1)(x).

4-2.5-405. Excused performance. Subject to section 4-2.5-404 on substituted performance, the following rules apply:

(a) Delay in delivery or nondelivery in whole or in part by lessor or a supplier who complies with paragraphs (b) and (c) is not a default under the lease contract if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the lease contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order, whether or not the regulation or order later proves to be invalid.

(b) If the causes mentioned in paragraph (a) affect only part of the lessor's or the supplier's capacity to perform, he or she shall allocate production and deliveries among his or her customers but at his or her option may include regular customers not then under contract for sale or lease as well as his or her own requirements for further manufacture. He or she may so allocate in any manner that is fair and reasonable.

(c) The lessor seasonably shall notify the lessee and in the case of a finance lease the supplier seasonably shall notify the lessor and the lessee, if known, that there will be delay or nondelivery and, if allocation is required under paragraph (b), of the estimated quota thus made available for the lessee.

Source: L. 91: Entire article added, p. 299, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-615.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Agreed". Section 1-201(3).
"Contract". Section 1-201(11).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Knows". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Sale". Section 2-106(1).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).

4-2.5-406. Procedure on excused performance. (1) If the lessee receives notification of a material or indefinite delay or an allocation justified under section 4-2.5-405, the lessee may by written notification to the lessor as to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (section 4-2.5-510):

(a) Terminate the lease contract (section 4-2.5-505 (2)); or

(b) Except in a finance lease that is not a consumer lease, modify the lease contract by accepting the available quota in substitution, with due allowance from the rent payable for the balance of the lease term for the deficiency but without further right against the lessor.

(2) If, after receipt of a notification from the lessor under section 4-2.5-405, the lessee fails so to modify the lease agreement within a reasonable time not exceeding thirty days, the lease contract lapses with respect to any deliveries affected.

Source: L. 91: Entire article added, p. 299, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-616(1) and (2).
Changes: Revised to reflect leasing practices and terminology. Note that subsection 1(a) allows the lessee under a lease, including a finance lease, the right to terminate the lease for excused performance (Sections 2A-404 and 2A-405). However, subsection 1(b), which allows the les-

see the right to modify the lease for excused performance, excludes a finance lease that is not a consumer lease. This exclusion is compelled by the same policy that led to codification of provisions with respect to irrevocable promises. Section 2A-407.

Definitional Cross References:

"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).
"Termination". Section 2A-103(1)(z).
"Value". Section 1-201(44).
"Written". Section 1-201(46).

4-2.5-407. Irrevocable promises: Finance leases. (1) In the case of a finance lease that is not a consumer lease the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods.

(2) A promise that has become irrevocable and independent under subsection (1) of this section:

(a) Is effective and enforceable between the parties, by or against third parties including assignees of the parties; and

(b) Is not subject to cancellation, termination, modification, repudiation, excuse, or substitution without the consent of the party to whom the promise runs.

(3) This section does not affect the validity under any other law of a covenant in any lease contract making the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods.

Source: L. 91: Entire article added, p. 300, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: None.

Purposes:

1. This section extends the benefits of the classic "hell or high water" clause to a finance lease that is not a consumer lease. This section is self-executing; no special provision need be added to the contract. This section makes covenants in a finance lease irrevocable and independent due to the function of the finance lessor in a three party relationship: the lessee is looking to the supplier to perform the essential covenants and warranties. Section 2A-209. Thus, upon the lessee's acceptance of the goods the lessee's promises to the lessor under the lease contract become irrevocable and independent. The provisions of this section remain subject to the obligation of good faith (Sections 2A-103(4) and 1-203), and the lessee's revocation of acceptance (Section 2A-517).

2. The section requires the lessee to perform even if the lessor's performance after the lessee's acceptance is not in accordance with the lease contract; the lessee may, however, have and pursue a cause of action against the lessor, e.g., breach of certain limited warranties (Sections 2A-210 and 2A- 211(1)). This is appropriate because the benefit of the supplier's promises and warranties to the lessor under the supply contract and, in some cases, the warranty of a manufacturer who is not the supplier, is extended to the lessee under the finance lease. Section 2A-209. Despite this balance, this section excludes a finance lease that is a consumer lease. That a consumer be obligated to pay notwithstanding defective goods or the like is a principle that is not tenable under case law (Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967)), state statute (Unif. Consumer Credit Code § § 3.403-.405, 7A U.L.A. 126-31 (1974), or federal statute (15 U.S.C. § 1666i (1982)).

3. The relationship of the three parties to a transaction that qualifies as a finance lease is best demonstrated by a hypothetical. A, the potential lessor, has been contacted by B, the potential lessee, to discuss the lease of an expensive line of equipment that B has recently placed an order for with C, the manufacturer of such goods. The negotiation is completed and A, as lessor, and B, as lessee, sign a lease of the line of equipment for a 60-month term. B, as buyer, assigns the purchase order with C to A. If this transaction creates a lease (Section 2A-103(1)(j)), this transaction should qualify as a finance lease. Section 2A-103(1)(g).

4. The line of equipment is delivered by C to B's place of business. After installation by C and testing by B, B accepts the goods by signing a certificate of delivery and acceptance, a copy of which is sent by B to A and C. One year later

the line of equipment malfunctions and B falls behind in its manufacturing schedule.

5. Under this Article, because the lease is a finance lease, no warranty of fitness or merchantability is extended by A to B. Sections 2A-212(1) and 2A-213. Absent an express provision in the lease agreement, application of Section 2A-210 or Section 2A-211(1), or application of the principles of law and equity, including the law with respect to fraud, duress, or the like (Sections 2A-103(4) and 1-103), B has no claim against A. B's obligation to pay rent to A continues as the obligation became irrevocable and independent when B accepted the line of equipment (Section 2A-407(1)). B has no right of set-off with respect to any part of the rent still due under the lease. Section 2A-508(6). However, B may have another remedy. Despite the lack of privity between B and C (the purchase order with C having been assigned by B to A), B may have a claim against C. Section 2A-209(1).

6. This section does not address whether a "hell or high water" clause, i.e., a clause that is to the effect of this section, is enforceable if included in a finance lease that is a consumer lease or a lease that is not a finance lease. That issue will continue to be determined by the facts of each case and other law which this section does not affect. Sections 2A-104, 2A-103(4), 9-206 and 9-318. However, with respect to finance leases that are not consumer leases courts have enforced "hell or high water" clauses. In re O.P.M. Leasing Servs., 21 Bankr. 993, 1006 (Bankr. S.D.N.Y. 1982).

7. Subsection (2) further provides that a promise that has become irrevocable and independent under subsection (1) is enforceable not only between the parties but also against third parties. Thus, the finance lease can be transferred or assigned without disturbing enforceability. Further, subsection (2) also provides that the promise cannot, among other things, be cancelled or terminated without the consent of the lessor.

Cross References:

Sections 1-103, 1-203, 2A-103(1)(g), 2A-103(1)(j), 2A-103(4), 2A-104, 2A-209, 2A-209(1), 2A-210, 2A-211(1), 2A-212(1), 2A-213, 2A-517(1)(b), 9-206 and 9-318.

Definitional Cross References:

"Cancellation". Section 2A-103(1)(b).
"Consumer lease". Section 2A-103(1)(e).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Party". Section 1-201(29).
"Termination". Section 2A-103(1)(z).

PART 5

DEFAULT

A. In General

4-2.5-501. Default: Procedure. (1) Whether the lessor or the lessee is in default under a lease contract is determined by the lease agreement and this article.

(2) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement has rights and remedies as provided in this article and, except as limited by this article, as provided in the lease agreement.

(3) If the lessor or the lessee is in default under the lease contract, the party seeking enforcement may reduce the party's claim to judgment, or otherwise enforce the lease contract by self-help or any available judicial procedure or nonjudicial procedure, including administrative proceeding, arbitration, or the like, in accordance with this article.

(4) Except as otherwise provided in section 4-1-305 (a) or this article or the lease agreement, the rights and remedies referred to in subsections (2) and (3) of this section are cumulative.

(5) If the lease agreement covers both real property and goods, the party seeking enforcement may proceed under this part 5 as to the goods, or under other applicable law as to both the real property and the goods in accordance with that party's rights and remedies in respect of the real property, in which case this part 5 does not apply.

Source: L. 91: Entire article added, p. 300, § 1, effective July 1, 1992. **L. 2006:** (4) amended, p. 493, § 17, effective September 1.

OFFICIAL COMMENT

Uniform Statutory Source: Section 9-501.
Changes: Substantially revised.
Purposes:

1. Subsection (1) is new and represents a departure from the Article on Secured Transactions (Article 9) as the subsection makes clear that whether a party to the lease agreement is in default is determined by this Article as well as the agreement. Sections 2A-508 and 2A-523. It further departs from Article 9 in recognizing the potential default of either party, a function of the bilateral nature of the obligations between the parties to the lease contract.
2. Subsection (2) is a version of the first sentence of Section 9-501(1), revised to reflect leasing terminology.
3. Subsection (3), an expansive version of the second sentence of Section 9-501(1), lists the procedures that may be followed by the party seeking enforcement; in effect, the scope of the procedures listed in subsection (3) is consistent with the scope of the procedures available to the foreclosing secured party.
4. Subsection (4) establishes that the parties' rights and remedies are cumulative. DeKoven, Leases of Equipment: Puritan Leasing Company v. August, A Dangerous Decision, 12 U.S.F. L. Rev. 257, 276-80 (1978). Cumulation, and largely unrestricted selection, of remedies is allowed in furtherance of the general policy of the Commercial Code, stated in Section 1-106, that remedies be liberally administered to put the aggrieved party in as good a position as if the other party had fully performed. Therefore, cumulation of, or selection among, remedies is available to the extent necessary to put the aggrieved party in as good a position as it would have been in had there been full performance. However, cumulation of, or selection among, remedies is not available to the extent that the cumulation or selection would put the aggrieved party in a better position than it would have been in had there been full performance by the other party.
5. Section 9-501(3), which, among other things, states that certain rules, to the extent they give rights to the debtor and impose duties on the secured party, may not be waived or varied, was not incorporated in this Article. Given the significance of freedom of contract in the development of the common law as it applies to bailments for hire and the lessee's lack of an equity of redemption, there was no reason to impose that restraint.

Cross References:

Sections 1-106, 2A-508, 2A-523, Article 9, especially Sections 9-501(1) and 9-501(3).

Definitional Cross References:

"Goods". Section 2A-103(1)(h).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

4-2.5-502. Notice after default. Except as otherwise provided in this article or the lease agreement, the lessor or lessee in default under the lease contract is not entitled to notice of default or notice of enforcement from the other party to the lease agreement.

Source: L. 91: Entire article added, p. 301, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: None.
Purposes: This section makes clear that absent agreement to the contrary or provision in this Article to the contrary, e.g., Section 2A-516(3)(a), the party in default is not entitled to notice of default or enforcement. While a review of Part 5 of Article 9 leads to the same conclusion with respect to giving notice of default to the debtor, it is never stated. Although Article 9 requires notice of disposition and strict foreclosure, the different scheme of lessors' and lessees' rights and remedies developed under the common law, and codified by this Article, generally does not require notice of enforcement; furthermore, such notice is not mandated by due process requirements. However, certain sections of this Article do require notice. E.g., Section 2A-517(2).

Cross References:

Sections 2A-516(3)(a), 2A-517(2), and Article 9, esp. Part 5.

Definitional Cross References:

"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).

4-2.5-503. Modification or impairment of rights and remedies. (1) Except as otherwise provided in this article, the lease agreement may include rights and remedies for

default in addition to or in substitution for those provided in this article and may limit or alter the measure of damages recoverable under this article.

(2) Resort to a remedy provided under this article or in the lease agreement is optional unless the remedy is expressly agreed to be exclusive. If circumstances cause an exclusive or limited remedy to fail of its essential purpose, or provision for an exclusive remedy is unconscionable, remedy may be had as provided in this article.

(3) Consequential damages may be liquidated under section 4-2.5-504, or may otherwise be limited, altered, or excluded unless the limitation, alteration, or exclusion is unconscionable. Limitation, alteration, or exclusion of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation, alteration, or exclusion of damages where the loss is commercial is not prima facie unconscionable.

(4) Rights and remedies on default by the lessor or the lessee with respect to any obligation or promise collateral or ancillary to the lease contract are not impaired by this article.

Source: L. 91: Entire article added, p. 301, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-719 and 2-701.

Changes: Rewritten to reflect lease terminology and to clarify the relationship between this section and Section 2A-504.

Purposes:

1. A significant purpose of this Part is to provide rights and remedies for those parties to a lease who fail to provide them by agreement or whose rights and remedies fail of their essential purpose or are unenforceable. However, it is important to note that this implies no restriction on freedom to contract. Sections 2A-103(4) and 1-102(3). Thus, subsection (1), a revised version of the provisions of Section 2-719(1), allows the parties to the lease agreement freedom to provide for rights and remedies in addition to or in substitution for those provided in this Article and to alter or limit the measure of damages recoverable under this Article. Except to the extent otherwise provided in this Article (e.g., Sections 2A-105, 106 and 108(1) and (2)), this Part shall be construed neither to restrict the parties' ability to provide for rights and remedies or to limit or alter the measure of damages by agreement, nor to imply disapproval of rights and remedy schemes other than those set forth in this Part.

2. Subsection (2) makes explicit with respect to this Article what is implicit in Section 2-719 with respect to the Article on Sales (Article 2): if an exclusive remedy is held to be unconscionable, remedies under this Article are available. Section 2-719 official comment 1.

3. Subsection (3), a revision of Section 2-719(3), makes clear that consequential damages may also be liquidated. Section 2A-504(1).

4. Subsection (4) is a revision of the provisions of Section 2-701. This subsection leaves the treatment of default with respect to obligations or promises collateral or ancillary to the lease contract to other law. Sections 2A-103(4) and 1-103. An example of such an obligation would be that of the lessor to the secured creditor which has provided the funds to leverage the lessor's lease transaction; an example of such a promise would be that of the lessee, as seller, to the lessor, as buyer, in a sale-leaseback transaction.

Cross References:

Sections 1-102(3), 1-103, Article 2, especially Sections 2-701, 2-719, 2-719(1), 2-719(3), 2-719 official comment 1, and Sections 2A-103(4), 2A-105, 2A-106, 2A-108(1), 2A-108(2), and 2A-504.

Definitional Cross References:

"Agreed". Section 1-201(3).
"Consumer goods". Section 9-109(1).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Person". Section 1-201(30).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

4-2.5-504. Liquidation of damages. (1) Damages payable by either party for default, or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission.

(2) If the lease agreement provides for liquidation of damages, and such provision does

not comply with subsection (1) of this section, or such provision is an exclusive or limited remedy that circumstances cause to fail of its essential purpose, remedy may be had as provided in this article.

(3) If the lessor justifiably withholds or stops delivery of goods because of the lessee's default or insolvency (section 4-2.5-525 or 4-2.5-526), the lessee is entitled to restitution of any amount by which the sum of his or her payments exceeds:

(a) The amount to which the lessor is entitled by virtue of terms liquidating the lessor's damages in accordance with subsection (1) of this section; or

(b) In the absence of those terms, twenty percent of the then present value of the total rent the lessee was obligated to pay for the balance of the lease term, or, in the case of a consumer lease, the lesser of such amount or five hundred dollars.

(4) A lessee's right to restitution under subsection (3) of this section is subject to offset to the extent the lessor establishes:

(a) A right to recover damages under the provisions of this article other than subsection (1) of this section; and

(b) The amount or value of any benefits received by the lessee directly or indirectly by reason of the lease contract.

Source: L. 91: Entire article added, p. 302, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-718(1), (2), (3) and 2-719(2).
Changes: Substantially rewritten.
Purposes:

Many leasing transactions are predicated on the parties' ability to agree to an appropriate amount of damages or formula for damages in the event of default or other act or omission. The rule with respect to sales of goods (Section 2-718) may not be sufficiently flexible to accommodate this practice. Thus, consistent with the common law emphasis upon freedom to contract with respect to bailments for hire, this section has created a revised rule that allows greater flexibility with respect to leases of goods.

Subsection (1), a significantly modified version of the provisions of Section 2-718(1), provides for liquidation of damages in the lease agreement at an amount or by a formula. Section 2-718(1) does not by its express terms include liquidation by a formula; this change was compelled by modern leasing practice. Subsection (1), in a further expansion of Section 2-718(1), provides for liquidation of damages for default as well as any other act or omission.

A liquidated damages formula that is common in leasing practice provides that the sum of lease payments past due, accelerated future lease payments, and the lessor's estimated residual interest, less the net proceeds of disposition (whether by sale or re-lease) of the leased goods is the lessor's damages. Tax indemnities, costs, interest and attorney's fees are also added to determine the lessor's damages. Another common liquidated damages formula utilizes a periodic depreciation allocation as a credit to the aforesaid amount in mitigation of a lessor's damages. A third formula provides for a fixed number of periodic payments as a means of liquidating damages. Stipulated loss or stipulated damage schedules are also common. Whether these formulae are enforceable will be determined in the context of each case by applying a standard of reasonableness in light of the harm anticipated when the formula was agreed to. Whether the inclusion of these formulae will affect the classification of the transaction as a lease or a security interest is to be determined by the facts of each case. Section 1-201(37). E.g., In re Noack, 44 Bankr. 172, 174-75 (Bankr. E.D. Wis. 1984).

This section does not incorporate two other tests that under sales law determine enforceability of liquidated damages, i.e., difficulties of proof of loss and inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. The ability to liquidate damages is critical to modern leasing practice; given the parties' freedom to contract at common law, the policy behind retaining these two additional requirements here was thought to be outweighed. Further, given the expansion of subsection (1) to enable the parties to liquidate the amount payable with respect to an indemnity for loss or diminution of anticipated tax benefits resulted in another change: the last sentence of Section 2-718(1), providing that a term fixing unreasonably large liquidated damages is void as a penalty, was also not incorporated. The impact of local, state and federal tax laws on a leasing transaction can result in an amount payable with respect to the tax indemnity many times greater than the original purchase price of the goods. By deleting the reference to unreasonably large liquidated damages the parties are free to negotiate a formula, restrained by the rule of reasonableness in this section. These changes should invite

the parties to liquidate damages. Peters, Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two, 73 Yale L.J. 199, 278 (1963).

Subsection (2), a revised version of Section 2-719(2), provides that if the liquidated damages provision is not enforceable or fails of its essential purpose, remedy may be had as provided in this Article.

Subsection (3)(b) of this section differs from subsection (2)(b) of Section 2-718; in the absence of a valid liquidated damages amount or formula the lessor is permitted to retain 20 percent of the present value of the total rent payable under the lease. The alternative limitation of $500 contained in Section 2-718 is deleted as unrealistically low with respect to a lease other than a consumer lease.

Cross References:
Sections 1-201(37), 2-718, 2-718(1), 2-718(2)(b) and 2-719(2).

Definitional Cross References:
"Consumer lease". Section 2A-103(1)(e).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lessor's residual interest". Section 2A-103(1)(q).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).
"Value". Section 1-201(44).

4-2.5-505. Cancellation and termination and effect of cancellation, termination, rescission, or fraud on rights and remedies. (1) On cancellation of the lease contract, all obligations that are still executory on both sides are discharged, but any right based on prior default or performance survives, and the cancelling party also retains any remedy for default of the whole lease contract or any unperformed balance.

(2) On termination of the lease contract, all obligations that are still executory on both sides are discharged but any right based on prior default or performance survives.

(3) Unless the contrary intention clearly appears, expressions of "cancellation", "rescission", or the like of the lease contract may not be construed as a renunciation or discharge of any claim in damages for an antecedent default.

(4) Rights and remedies for material misrepresentation or fraud include all rights and remedies available under this article for default.

(5) Neither rescission nor a claim for rescission of the lease contract nor rejection or return of the goods may bar or be deemed inconsistent with a claim for damages or other right or remedy.

Source: L. 91: Entire article added, p. 302, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-106(3) and (4), 2-720 and 2-721.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Cancellation". Section 2A-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Termination". Section 2A-103(1)(z).

4-2.5-506. Statute of limitations. (1) An action for default under a lease contract, including breach of warranty or indemnity, must be commenced within the time period prescribed in section 13-80-101, C.R.S. This period of limitation may not be varied by agreement of the parties.

(2) A cause of action for default accrues when the act or omission on which the default or breach of warranty is based is or should have been discovered by the aggrieved party, or when the default occurs, whichever is later. A cause of action for indemnity accrues when the act or omission on which the claim for indemnity is based is or should have been discovered by the indemnified party, whichever is later.

(3) If an action commenced within the time limited by subsection (1) of this section is

so terminated as to leave available a remedy by another action for the same default or breach of warranty or indemnity, the other action may be commenced after the expiration of the time limited and within 6 months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action that have accrued before this article becomes effective.

Source: L. 91: Entire article added, p. 303, § 1, effective July 1, 1992.

Editor's note - Colorado legislative change: In the first sentence of subsection (1) of this section, after the words "must be commenced within", Colorado deleted the words "4 years after the cause of action accrued." and substituted the words "the time period prescribed in section 13-80-101, C.R.S.". Colorado deleted the second sentence (which read: "By the original lease contract the parties may reduce the period of limitation to not less than one year.") and substituted the following sentence: "This period of limitation may not be varied by agreement of the parties.". These changes parallel the changes that Colorado had previously made to section 4-2-725 (1).

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-725.
Changes: Substantially rewritten.
Purposes:

Subsection (1) does not incorporate the limitation found in Section 2-725(1) prohibiting the parties from extending the period of limitation. Breach of warranty and indemnity claims often arise in a lease transaction; with the passage of time such claims often diminish or are eliminated. To encourage the parties to commence litigation under these circumstances makes little sense.

Subsection (2) states two rules for determining when a cause of action accrues. With respect to default, the rule of Section 2-725(2) is not incorporated in favor of a more liberal rule of the later of the date when the default occurs or when the act or omission on which it is based is or should have been discovered. With respect to indemnity, a similarly liberal rule is adopted.

Cross References:

Sections 2-725(1) and 2-725(2).

Definitional Cross References:

"Action". Section 1-201(1).
"Aggrieved party". Section 1-201(2).
"Lease contract". Section 2A-103(1)(l).
"Party". Section 1-201(29).
"Remedy". Section 1-201(34).
"Termination". Section 2A-103(1)(z).

4-2.5-507. Proof of market rent: time and place. (1) Damages based on market rent (section 4-2.5-519 or 4-2.5-528) are determined according to the rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times specified in sections 4-2.5-519 and 4-2.5-528.

(2) If evidence of rent for the use of the goods concerned for a lease term identical to the remaining lease term of the original lease agreement and prevailing at the times or places described in this article is not readily available, the rent prevailing within any reasonable time before or after the time described or at any other place or for a different lease term which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the difference, including the cost of transporting the goods to or from the other place.

(3) Evidence of a relevant rent prevailing at a time or place or for a lease term other than the one described in this article offered by one party is not admissible unless and until he or she has given the other party notice the court finds sufficient to prevent unfair surprise.

(4) If the prevailing rent or value of any goods regularly leased in any established market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of that market are admissible in evidence. The circumstances of the preparation of the report may be shown to affect its weight but not its admissibility.

Source: L. 91: Entire article added, p. 303, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-723 and 2-724.
Changes: Revised to reflect leasing practices and terminology. Sections 2A-519 and 2A-528 specify the times as of which market rent is to be determined.
Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Notice". Section 1-201(25).
"Party". Section 1-201(29).
"Reasonable time". Section 1-204(1) and (2).
"Usage of trade". Section 1-205.
"Value". Section 1-201(44).

B. Default by Lessor

4-2.5-508. Lessee's remedies. (1) If a lessor fails to deliver the goods in conformity to the lease contract (section 4-2.5-509) or repudiates the lease contract (section 4-2.5-402), or a lessee rightfully rejects the goods (section 4-2.5-509) or justifiably revokes acceptance of the goods (section 4-2.5-517), then with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (section 4-2.5-510), the lessor is in default under the lease contract and the lessee may:

(a) Cancel the lease contract (section 4-2.5-505 (1));

(b) Recover so much of the rent and security as has been paid and is just under the circumstances;

(c) Cover and recover damages as to all goods affected whether or not they have been identified to the lease contract (sections 4-2.5-518 and 4-2.5-520), or recover damages for nondelivery (sections 4-2.5-519 and 4-2.5-520);

(d) Exercise any other rights or pursue any other remedies provided in the lease contract.

(2) If a lessor fails to deliver the goods in conformity to the lease contract or repudiates the lease contract, the lessee may also:

(a) If the goods have been identified, recover them (section 4-2.5-522); or

(b) In a proper case, obtain specific performance or replevy the goods (section 4-2.5-521).

(3) If a lessor is otherwise in default under a lease contract, the lessee may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease, and in section 4-2.5-519 (3).

(4) If a lessor has breached a warranty, whether express or implied, the lessee may recover damages (section 4-2.5-519 (4)).

(5) On rightful rejection or justifiable revocation of acceptance, a lessee has a security interest in goods in the lessee's possession or control for any rent and security that has been paid and any expenses reasonably incurred in their inspection, receipt, transportation, and care and custody and may hold those goods and dispose of them in good faith and in a commercially reasonable manner, subject to section 4-2.5-527 (5).

(6) Subject to the provisions of section 4-2.5-407, a lessee, on notifying the lessor of the lessee's intention to do so, may deduct all or any part of the damages resulting from any default under the lease contract from any part of the rent still due under the same lease contract.

Source: L. 91: Entire article added, p. 304, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-711 and 2-717.
Changes: Substantially rewritten.
Purposes:
1. This section is an index to Sections 2A-509 through 522 which set out the lessee's rights

and remedies after the lessor's default. The lessor and the lessee can agree to modify the rights and remedies available under this Article; they can, among other things, provide that for defaults other than those specified in subsection (1) the lessee can exercise the rights and remedies referred to in subsection (1); and they can create a new scheme of rights and remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3).

2. Subsection (1), a substantially rewritten version of the provisions of Section 2-711(1), lists three cumulative remedies of the lessee where the lessor has failed to deliver conforming goods or has repudiated the contract, or the lessee has rightfully rejected or justifiably revoked. Sections 2A-501(2) and (4). Subsection (1) also allows the lessee to exercise any contractual remedy. This Article rejects any general doctrine of election of remedy. To determine if one remedy bars another in a particular case is a function of whether the lessee has been put in as good a position as if the lessor had fully performed the lease agreement. Use of multiple remedies is barred only if the effect is to put the lessee in a better position than it would have been in had the lessor fully performed under the lease. Sections 2A-103(4), 2A-501(4), and 1-106(1). Subsection (1)(b), in recognition that no bright line can be created that would operate fairly in all installment lease cases and in recognition of the fact that a lessee may be able to cancel the lease (revoke acceptance of the goods) after the goods have been in use for some period of time, does not require that all lease payments made by the lessee under the lease be returned upon cancellation. Rather, only such portion as is just of the rent and security payments made may be recovered. If a defect in the goods is discovered immediately upon tender to the lessee and the goods are rejected immediately, then the lessee should recover all payments made. If, however, for example, a 36-month equipment lease is terminated in the 12th month because the lessor has materially breached the contract by failing to perform its maintenance obligations, it may be just to return only a small part or none of the rental payments already made.

3. Subsection (2), a version of the provisions of Section 2-711(2) revised to reflect leasing terminology, lists two alternative remedies for the recovery of the goods by the lessee; however, each of these remedies is cumulative with respect to those listed in subsection (1).

4. Subsection (3) is new. It covers defaults which do not deprive the lessee of the goods and which are not so serious as to justify rejection or revocation of acceptance under subsection (1). It also covers defaults for which the lessee could have rejected or revoked acceptance of the goods but elects not to do so and retains the goods. In either case, a lessee which retains the goods is entitled to recover damages as stated in Section 2A-519(3). That measure of damages is "the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable together with incidental and consequential damages, less expenses saved in consequence of the lessor's breach."

5. Subsection (1)(d) and subsection (3) recognize that the lease agreement may provide rights and remedies in addition to or different from those which Article 2A provides. In particular, subsection (3) provides that the lease agreement may give the remedy of cancellation of the lease for defaults by the lessor that would not otherwise be material defaults which would justify cancellation under subsection (1). If there is a right to cancel, there is, of course, a right to reject or revoke acceptance of the goods.

6. Subsection (4) is new and merely adds to the completeness of the index by including a reference to the lessee's recovery of damages upon the lessor's breach of warranty; such breach may not rise to the level of a default by the lessor justifying revocation of acceptance. If the lessee properly rejects or revokes acceptance of the goods because of a breach of warranty, the rights and remedies are those provided in subsection (1) rather than those in Section 2A-519(4).

7. Subsection (5), a revised version of the provisions of Section 2-711(3), recognizes, on rightful rejection or justifiable revocation, the lessee's security interest in goods in its possession and control. Section 9-113, which recognized security interests arising under the Article on Sales (Article 2), was amended with the adoption of this Article to reflect the security interests arising under this Article. Pursuant to Section 2A-511(4), a purchaser who purchases goods from the lessee in good faith takes free of any rights of the lessor, or in the case of a finance lease the supplier. Such goods, however, must have been rightfully rejected and disposed of pursuant to Section 2A-511 or 2A-512. However, Section 2A-517(5) provides that the lessee will have the same rights and duties with respect to goods where acceptance has been revoked as with respect to goods rejected. Thus, Section 2A-511(4) will apply to the lessee's disposition of such goods.

8. Pursuant to Section 2A-527(5), the lessee must account to the lessor for the excess proceeds of such disposition, after satisfaction of the claim secured by the lessee's security interest.

9. Subsection (6), a slightly revised version of the provisions of Section 2-717, sanctions a right of set-off by the lessee, subject to the rule of Section 2A-407 with respect to irrevocable promises in a finance lease that is not a consumer lease, and further subject to an enforceable "hell or high water" clause in the lease

agreement. Section 2A-407 official comment. No attempt is made to state how the set-off should occur; this is to be determined by the facts of each case.

10. There is no special treatment of the finance lease in this section. Absent supplemental principles of law and equity to the contrary, in the case of most finance leases, following the lessee's acceptance of the goods the lessee will have no rights or remedies against the lessor, because the lessor's obligations to the lessee are minimal. Sections 2A-210 and 2A-211(1). Since the lessee will look to the supplier for performance, this is appropriate. Section 2A-209.

Cross References:

Sections 1-102(3), 1-103, 1-106(1), Article 2, especially Sections 2-711, 2-717 and Sections 2A-103(4), 2A-209, 2A-210, 2A-211(1), 2A-407, 2A-501(2), 2A-501(4), 2A-509 through 2A-522, 2A-511(3), 2A-517(5), 2A-527(5) and Section 9-113.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Value". Section 1-201(44).

4-2.5-509. Lessee's rights on improper delivery; rightful rejection. (1) Subject to the provisions of section 4-2.5-510 on default in installment lease contracts, if the goods or the tender or delivery fail in any respect to conform to the lease contract, the lessee may reject or accept the goods or accept any commercial unit or units and reject the rest of the goods.

(2) Rejection of goods is ineffective unless it is within a reasonable time after tender or delivery of the goods and the lessee seasonably notifies the lessor.

Source: L. 91: Entire article added, p. 305, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-601 and 2-602(1).

Changes: Revised to reflect leasing practices and terminology.

Definitional Cross References:

"Commercial unit". Section 2A-103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).

4-2.5-510. Installment lease contracts: rejection and default. (1) Under an installment lease contract a lessee may reject any delivery that is nonconforming if the nonconformity substantially impairs the value of that delivery and cannot be cured or the nonconformity is a defect in the required documents; but if the nonconformity does not fall within subsection (2) of this section and the lessor or the supplier gives adequate assurance of its cure, the lessee must accept that delivery.

(2) Whenever nonconformity or default with respect to one or more deliveries substantially impairs the value of the installment lease contract as a whole there is a default with respect to the whole. But, the aggrieved party reinstates the installment lease contract as a whole if the aggrieved party accepts a nonconforming delivery without seasonably notifying of cancellation or brings an action with respect only to past deliveries or demands performance as to future deliveries.

Source: L. 91: Entire article added, p. 305, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-612.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Action". Section 1-201(1)
"Aggrieved party". Section 1-201(2).
"Cancellation". Section 2A-103(1)(b).
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Installment lease contract". Section 2A-103(1)(i).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies". Section 1-201(26).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

4-2.5-511. Merchant lessee's duties as to rightfully rejected goods. (1) Subject to any security interest of a lessee (section 4-2.5-508 (5)), if a lessor or a supplier has no agent or place of business at the market of rejection, a merchant lessee, after rejection of goods in his or her possession or control, shall follow any reasonable instructions received from the lessor or the supplier with respect to the goods. In the absence of those instructions, a merchant lessee shall make reasonable efforts to sell, lease, or otherwise dispose of the goods for the lessor's account if they threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) If a merchant lessee (subsection (1)) or any other lessee (section 4-2.5-512) disposes of goods, he or she is entitled to reimbursement either from the lessor or the supplier or out of the proceeds for reasonable expenses of caring for and disposing of the goods and, if the expenses include no disposition commission, to such commission as is usual in the trade, or if there is none, to a reasonable sum not exceeding ten percent of the gross proceeds.

(3) In complying with this section or section 4-2.5-512, the lessee is held only to good faith. Good faith conduct hereunder is neither acceptance or conversion nor the basis of an action for damages.

(4) A purchaser who purchases in good faith from a lessee pursuant to this section or section 4-2.5-512 takes the goods free of any rights of the lessor and the supplier even though the lessee fails to comply with one or more of the requirements of this article.

Source: L. 91: Entire article added, p. 306, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-603 and 2-706(5).
Changes: Revised to reflect leasing practices and terminology. This section, by its terms, applies to merchants as well as others. Thus, in construing the section it is important to note that under this Act the term good faith is defined differently for merchants (Section 2-103(1)(b)) than for others (Section 1-201(19)). Section 2A-103(3) and (4).
Definitional Cross References:
"Action". Section 1-201(1).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Merchant lessee". Section 2A-103(1)(t).
"Purchaser". Section 1-201(33).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

4-2.5-512. Lessee's duties as to rightfully rejected goods. (1) Except as otherwise provided with respect to goods that threaten to decline in value speedily (section 4-2.5-511) and subject to any security interest of a lessee (section 4-2.5-508 (5)):

(a) The lessee, after rejection of goods in the lessee's possession, shall hold them with reasonable care at the lessor's or the supplier's disposition for a reasonable time after the lessee's seasonable notification of rejection;

(b) If the lessor or the supplier gives no instructions within a reasonable time after notification of rejection, the lessee may store the rejected goods for the lessor's or the supplier's account or ship them to the lessor or the supplier or dispose of them for the

lessor's or the supplier's account with reimbursement in the manner provided in section 4-2.5-511; but

(c) The lessee has no further obligations with regard to goods rightfully rejected.

(2) Action by the lessee pursuant to subsection (1) of this section is not acceptance or conversion.

Source: L. 91: Entire article added, p. 306, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-602(2)(b) and (c) and 2-604.
Changes: Substantially rewritten.
Purposes: The introduction to subsection (1) references goods that threaten to decline in value speedily and not perishables, the reference in Section 2-604, the statutory analogue. This is a change in style, not substance, as the first phrase includes the second. Subparagraphs (a) and (c) are revised versions of the provisions of Section 2-602(2)(b) and (c). Subparagraph (a) states the rule with respect to the lessee's treatment of goods in its possession following rejection; subparagraph (b) states the rule regarding such goods if the lessor or supplier then fails to give instructions to the lessee. If the lessee performs in a fashion consistent with subparagraphs (a) and (b), subparagraph (c) exonerates the lessee.
Cross References:
Sections 2-602(2)(b), 2-602(2)(c) and 2-604.
Definitional Cross References:
"Action". Section 1-201(1).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Seasonably". Section 1-204(3).
"Security interest". Section 1-201(37).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

4-2.5-513. Cure by lessor of improper tender or delivery; replacement. (1) If any tender or delivery by the lessor or the supplier is rejected because nonconforming and the time for performance has not yet expired, the lessor or the supplier may seasonably notify the lessee of the lessor's or the supplier's intention to cure and may then make a conforming delivery within the time provided in the lease contract.

(2) If the lessee rejects a nonconforming tender that the lessor or the supplier had reasonable grounds to believe would be acceptable with or without money allowance, the lessor or the supplier may have a further reasonable time to substitute a conforming tender if he or she seasonably notifies the lessee.

Source: L. 91: Entire article added, p. 307, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-508.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Conforming". Section 2A-103(1)(d).
"Delivery". Section 1-201(14).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Money". Section 1-201(24).
"Notifies". Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).

4-2.5-514. Waiver of lessee's objections. (1) In rejecting goods, a lessee's failure to state a particular defect that is ascertainable by reasonable inspection precludes the lessee from relying on the defect to justify rejection or to establish default:

(a) If, stated seasonably, the lessor or the supplier could have cured it (section 4-2.5-513); or

(b) Between merchants if the lessor or the supplier after rejection has made a request in writing for a full and final written statement of all defects on which the lessee proposes to rely.

(2) A lessee's failure to reserve rights when paying rent or other consideration against documents precludes recovery of the payment for defects apparent in the documents.

Source: L. 91: Entire article added, p. 307, § 1, effective July 1, 1992. **L. 2006:** (2) amended, p. 494, § 18, effective September 1.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-605.
Changes: Revised to reflect leasing practices and terminology.
Purposes: The principles applicable to the commercial practice of payment against documents (subsection 2) are explained in official comment 4 to Section 2-605, the statutory analogue to this section.
Cross Reference:
Section 2-605 official comment 4.

Definitional Cross References:
"Between merchants". Section 2-104(3).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).
"Writing". Section 1-201(46).

4-2.5-515. Acceptance of goods. (1) Acceptance of goods occurs after the lessee has had a reasonable opportunity to inspect the goods and:

(a) The lessee signifies or acts with respect to the goods in a manner that signifies to the lessor or the supplier that the goods are conforming or that the lessee will take or retain them in spite of their nonconformity; or

(b) The lessee fails to make an effective rejection of the goods (section 4-2.5-509 (2)).

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

Source: L. 91: Entire article added, p. 308, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-606.
Changes: The provisions of Section 2-606(1)(a) were substantially rewritten to provide that the lessee's conduct may signify acceptance. Further, the provisions of Section 2-606(1)(c) were not incorporated as irrelevant given the lessee's possession and use of the leased goods.
Cross References:
Sections 2-606(1)(a) and 2-606(1)(c).

Definitional Cross References:
"Commercial unit". Section 2A-103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Supplier". Section 2A-103(1)(x).

4-2.5-516. Effect of acceptance of goods; notice of default; burden of establishing default after acceptance; notice of claim or litigation to person answerable over. (1) A lessee must pay rent for any goods accepted in accordance with the lease contract with due allowance for goods rightfully rejected or not delivered.

(2) A lessee's acceptance of goods precludes rejection of the goods accepted. In the case of a finance lease, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it. In any other case, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured. Acceptance does not of itself impair any other remedy provided by this article or the lease agreement for nonconformity.

(3) If a tender has been accepted:

(a) Within a reasonable time after the lessee discovers or should have discovered any default, the lessee shall notify the lessor and the supplier, if any, or be barred from any remedy against the party not notified;

(b) Except in the case of a consumer lease, within a reasonable time after the lessee receives notice of litigation for infringement or the like (section 4-2.5-211) the lessee shall

notify the lessor or be barred from any remedy over for liability established by the litigation; and

(c) The burden is on the lessee to establish any default.

(4) If a lessee is sued for breach of a warranty or other obligation for which a lessor or a supplier is answerable over the following apply:

(a) The lessee may give the lessor or the supplier, or both, written notice of the litigation. If the notice states that the person notified may come in and defend and that if the person notified does not do so that person will be bound in any action against that person by the lessee by any determination of fact common to the two litigations, then unless the person notified after seasonable receipt of the notice does come in and defend that person is so bound.

(b) The lessor or the supplier may demand in writing that the lessee turn over control of the litigation including settlement if the claim is one for infringement or the like (section 4-2.5-211) or else be barred from any remedy over. If the demand states that the lessor or the supplier agrees to bear all expense and to satisfy any adverse judgment, then unless the lessee after seasonable receipt of the demand does turn over control the lessee is so barred.

(5) Subsections (3) and (4) of this section apply to any obligation of a lessee to hold the lessor or the supplier harmless against infringement or the like (section 4-2.5-211).

Source: L. 91: Entire article added, p. 308, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-607.
Changes: Substantially revised.
Purposes:

1. Subsection (2) creates a special rule for finance leases, precluding revocation if acceptance is made with knowledge of nonconformity with respect to the lease agreement, as opposed to the supply agreement; this is not inequitable as the lessee has a direct claim against the supplier. Section 2A-209(1). Revocation of acceptance of a finance lease is permitted if the lessee's acceptance was without discovery of the nonconformity (with respect to the lease agreement, not the supply agreement) and was reasonably induced by the lessor's assurances. Section 2A-517(1)(b). Absent exclusion or modification, the lessor under a finance lease makes certain warranties to the lessee. Sections 2A-210 and 2A-211(1). Revocation of acceptance is not prohibited even after the lessee's promise has become irrevocable and independent. Section 2A-407 official comment. Where the finance lease creates a security interest, the rule may be to the contrary. General Elec. Credit Corp. of Tennessee v. Ger-Beck Mach. Co., 806 F.2d 1207 (3rd Cir. 1986).

2. Subsection (3)(a) requires the lessee to give notice of default, within a reasonable time after the lessee discovered or should have discovered the default. In a finance lease, notice may be given either to the supplier, the lessor, or both, but remedy is barred against the party not notified. In a finance lease, the lessor is usually not liable for defects in the goods and the essential notice is to the supplier. While notice to the finance lessor will often not give any additional rights to the lessee, it would be good practice to give the notice since the finance lessor has an interest in the goods. Subsection (3)(a) does not use the term finance lease, but the definition of supplier is a person from whom a lessor buys or leases goods to be leased under a finance lease. Section 2A-103(1)(x). Therefore, there can be a "supplier" only in a finance lease. Subsection (4) applies similar notice rules as to lessors and suppliers if a lessee is sued for a breach of warranty or other obligation for which a lessor or supplier is answerable over.

3. Subsection (3)(b) requires the lessee to give the lessor notice of litigation for infringement or the like. There is an exception created in the case of a consumer lease. While such an exception was considered for a finance lease, it was not created because it was not necessary - the lessor in a finance lease does not give a warranty against infringement. Section 2A-211(2). Even though not required under subsection (3)(b), the lessee who takes under a finance lease should consider giving notice of litigation for infringement or the like to the supplier, because the lessee obtains the benefit of the suppliers' promises subject to the suppliers' defenses or claims. Sections 2A-209(1) and 2-607(3)(b).

Cross References:

Sections 2-607(3)(b), 2A-103(1)(x), 2A-209(1), 2A-210, 2A-211(1), 2A-211(2), 2A-407 official comment and 2A-517(1)(b).

Definitional Cross References:

"Action". Section 1-201(1).
"Agreement". Section 1-201(3).
"Burden of establishing". Section 1-201(8).
"Conforming". Section 2A-103(1)(d).
"Consumer lease". Section 2A-103(1)(e).

"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Knowledge". Section 1-201(25).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notice". Section 1-201(25).
"Notifies". Section 1-201(26).
"Person". Section 1-201(30).
"Reasonable time". Section 1-204(1) and (2).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Seasonably". Section 1-204(3).
"Supplier". Section 2A-103(1)(x).
"Written". Section 1-201(46).

4-2.5-517. Revocation of acceptance of goods. (1) A lessee may revoke acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to the lessee if he or she has accepted it:

(a) Except in the case of a finance lease, on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

(b) Without discovery of the nonconformity if the lessee's acceptance was reasonably induced either by the lessor's assurances or, except in the case of a finance lease, by the difficulty of discovery before acceptance.

(2) Except in the case of a finance lease that is not a consumer lease, a lessee may revoke acceptance of a lot or commercial unit if the lessor defaults under the lease contract and the default substantially impairs the value of that lot or commercial unit to the lessee.

(3) If the lease agreement so provides, the lessee may revoke acceptance of a lot or commercial unit because of other defaults by the lessor.

(4) Revocation of acceptance must occur within a reasonable time after the lessee discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by the nonconformity. Revocation is not effective until the lessee notifies the lessor.

(5) A lessee who so revokes has the same rights and duties with regard to the goods involved as if the lessee had rejected them.

Source: L. 91: Entire article added, p. 309, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-608.
Changes: Revised to reflect leasing practices and terminology. Note that in the case of a finance lease the lessee retains a limited right to revoke acceptance. Sections 2A-517(1)(b) and 2A-516 official comment. New subsections (2) and (3) added.
Purposes:
1. The section states the situations under which the lessee may return the goods to the lessor and cancel the lease. Subsection (2) recognizes that the lessor may have continuing obligations under the lease and that a default as to those obligations may be sufficiently material to justify revocation of acceptance of the leased items and cancellation of the lease by the lessee. For example, a failure by the lessor to fulfill its obligation to maintain leased equipment or to supply other goods which are necessary for the operation of the leased equipment may justify revocation of acceptance and cancellation of the lease.
2. Subsection (3) specifically provides that the lease agreement may provide that the lessee can revoke acceptance for defaults by the lessor which in the absence of such an agreement might not be considered sufficiently serious to justify revocation. That is, the parties are free to contract on the question of what defaults are so material that the lessee can cancel the lease.
Cross Reference:
Section 2A-516 official comment.
Definitional Cross References:
"Commercial unit". Section 2A-103(1)(c).
"Conforming". Section 2A-103(1)(d).
"Discover". Section 1-201(25).
"Finance lease". Section 2A-103(1)(g).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Lot". Section 2A-103(1)(s).
"Notifies." Section 1-201(26).
"Reasonable time". Section 1-204(1) and (2).
"Rights". Section 1-201(36).
"Seasonably". Section 1-204(3).
"Value". Section 1-201(44).

4-2.5-518. Cover; substitute goods. (1) After a default by a lessor under the lease contract of the type described in section 4-2.5-508 (1), or, if agreed, after other default by the lessor, the lessee may cover by making any purchase or lease of or contract to purchase or lease goods in substitution for those due from the lessor.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (section 4-2.5-504) or otherwise determined pursuant to agreement of the parties (sections 4-1-302 and 4-2.5-503), if a lessee's cover is by lease agreement substantially similar to the original lease agreement and the lease agreement is made in good faith and in a commercially reasonable manner, the lessee may recover from the lessor as damages (i) the present value, as of the date of the commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period of the new lease term that is comparable to the then remaining term of the original lease agreement minus the present value as of the same date of the total rent for the then remaining lease term of the original lease agreement, (ii) interest on the amount computed under clause (i) of this subsection (2) from the date of the commencement of the term of the new lease agreement until the date of entry of judgment at the same rate used in computing present value, and (iii) any incidental or consequential damages less expenses saved in consequence of the lessor's default.

(3) If a lessee's cover is by lease agreement that for any reason does not qualify for treatment under subsection (2) of this section, or is by purchase or otherwise, the lessee may recover from the lessor as if the lessee had elected not to cover and section 4-2.5-519 governs.

Source: L. 91: Entire article added, p. 310, § 1, effective July 1, 1992. **L. 2006:** (2) amended, p. 494, § 19, effective September 1.

Editor's note - Colorado legislative change. In subsection (2) of this section, after the words "term of the original lease agreement,", Colorado inserted a new clause as follows: "(ii) interest on the amount computed under clause (i) of this subsection (2) from the date of the commencement of the term of the new lease agreement until the date of entry of judgment at the same rate used in computing present value,". The second clause was then relettered as clause "(iii)".

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-712.
Changes: Substantially revised.
Purposes:

1. Subsection (1) allows the lessee to take action to fix its damages after default by the lessor. Such action may consist of the lease of goods. The decision to cover is a function of commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9-507.

2. Subsection (2) states a rule for determining the amount of lessee's damages provided that there is no agreement to the contrary. The lessee's damages will be established using the new lease agreement as a measure if the following three criteria are met: (i) the lessee's cover is by lease agreement, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such cover was effected in good faith, and in a commercially reasonable manner. Thus, the lessee will be entitled to recover from the lessor the present value, as of the date of commencement of the term of the new lease agreement, of the rent under the new lease agreement applicable to that period which is comparable to the then remaining term of the original lease agreement less the present value of the rent reserved for the remaining term under the original lease, together with incidental or consequential damages less expenses saved in consequence of the lessor's default. Consequential damages may include loss suffered by the lessee because of deprivation of the use of the goods during the period between the default and the acquisition of the goods under the new lease agreement. If the lessee's cover does not satisfy the criteria of subsection (2), Section 2A-519 governs.

3. Two of the three criteria to be met by the lessee are familiar, but the concept of the new lease agreement being substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. Thus, the decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

4. While the section does not draw a bright line, it is possible to describe some of the factors

that should be considered in finding that a new lease agreement is substantially similar to the original. First, the goods subject to the new lease agreement should be examined. For example, in a lease of computer equipment the new lease might be for more modern equipment. However, it may be that at the time of the lessor's breach it was not possible to obtain the same type of goods in the market place. Because the lessee's remedy under Section 2A-519 is intended to place the lessee in essentially the same position as if he had covered, if goods similar to those to have been delivered under the original lease are not available, then the computer equipment in this hypothetical should qualify as a commercially reasonable substitute. See Section 2-712(1).

5. Second, the various elements of the new lease agreement should also be examined. Those elements include the presence or absence of options to purchase or release; the lessor's representations, warranties and covenants to the lessee, as well as those to be provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid. If the differences between the original lease and the new lease can be easily valued, it would be appropriate for a court to adjust the difference in rental to take account of the difference between the two leases, find that the new lease is substantially similar to the old lease, and award cover damages under this section. If, for example, the new lease requires the lessor to insure the goods in the hands of the lessee, while the original lease required the lessee to insure, the usual cost of such insurance could be deducted from the rent due under the new lease before determining the difference in rental between the two leases.

6. Having examined the goods and the agreement, the test to be applied is whether, in light of these comparisons, the new lease agreement is substantially similar to the original lease agreement. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently with respect to the goods and each element of the agreement, as it is important that a sense of commercial judgment pervade the finding. To establish the new lease as a proper measure of damage under subsection (2), these factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original.

7. A new lease can be substantially similar to the original lease even though its term extends beyond the remaining term of the original lease, so long as both (a) the lease terms are commercially comparable (e.g., it is highly unlikely that a one-month rental and a five-year lease would reflect similar commercial realities), and (b) the court can fairly apportion a part of the rental payments under the new lease to that part of the term of the new lease which is comparable to the remaining lease term under the original lease. Also, the lease term of the new lease may be comparable to the term of the original lease even though the beginning and ending dates of the two leases are not the same. For example, a two-month lease of agricultural equipment for the months of August and September may be comparable to a two-month lease running from the 15th of August to the 15th of October if in the particular location two-month leases beginning on August 15th are basically interchangeable with two-month leases beginning August 1st. Similarly, the term of a one-year truck lease beginning on the 15th of January may be comparable to the term of a one-year truck lease beginning January 2d. If the lease terms are found to be comparable, the court may base cover damages on the entire difference between the costs under the two leases.

Cross References:

Sections 2-712(1), 2A-519 and 9-507.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Contract". Section 1-201(11).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(l)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Purchase". Section 2A-103(1)(v).

4-2.5-519. Lessee's damages for nondelivery, repudiation, default and breach of warranty in regard to accepted goods. (1) Except as otherwise provided with respect to damages liquidated in the lease agreement (section 4-2.5-504) or otherwise determined pursuant to agreement of the parties (sections 4-1-302 and 4-2.5-503), if a lessee elects not to cover or a lessee elects to cover and the cover is by lease agreement that for any reason does not qualify for treatment under section 4-2.5-518 (2), or is by purchase or otherwise, the lessee may recover from the lessor as damages for nondelivery or repudiation by the lessor or for rejection or revocation of acceptance by the lessee the present value, as of the date of the default, of the then market rent minus the present value as of the same date of the original rent, computed for the remaining lease term of the original lease agreement,

plus interest on the remainder so computed from the date of default until the date of entry of judgment at the same rate used in computing present value, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(2) Market rent is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

(3) Except as otherwise agreed if the lessee has accepted goods and given notification (section 4-2.5-516 (3)), the measure of damages for non-conforming tender or delivery or other default by a lessor is the loss resulting in the ordinary course of events from the lessor's default as determined in any manner that is reasonable together with incidental and consequential damages, less expenses saved in consequence of the lessor's default.

(4) Except as otherwise agreed, the measure of damages for breach of warranty is the present value at the time and place of acceptance of the difference between the value of the use of the goods accepted and the value if they had been as warranted for the lease term, unless special circumstances show proximate damages of a different amount, together with incidental and consequential damages, less expenses saved in consequence of the lessor's default or breach of warranty.

Source: L. 91: Entire article added, p. 310, § 1, effective July 1, 1992. **L. 2006:** (1) amended, p. 494, § 20, effective September 1.

Editor's note: Colorado legislative change. In subsection (1) of this section, after the words "by purchase or otherwise,", Colorado deleted the words "the measure of" and substituted the words "the lessee may recover from the lessor as", and, after the words "original lease agreement,", Colorado inserted the words "plus interest on the remainder so computed from the date of default until the date of entry of judgment at the same rate used in computing present value,".

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-713 and 2-714.

Changes: Substantially revised.

Purposes:

1. Subsection (1), a revised version of the provisions of Section 2-713(1), states the basic rule governing the measure of lessee's damages for non- delivery or repudiation by the lessor or for rightful rejection or revocation of acceptance by the lessee. This measure will apply, absent agreement to the contrary, if the lessee does not cover or if the cover does not qualify under Section 2A-518. There is no sanction for cover that does not qualify.

2. The measure of damage is the present value, as of the date of default, of the market rent for the remaining term of the lease less the present value of the original rent for the remaining term of the lease, plus incidental and consequential damages less expenses saved in consequence of the default. Note that the reference in Section 2A-519(1) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, § 5-1, at 216-217 (1971). Section 2A-501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103.

3. Subsection (2), a revised version of the provisions of Section 2-713(2), states the rule with respect to determining market rent.

4. Subsection (3), a revised version of the provisions of Section 2-714(1) and (3), states the measure of damages where goods have been accepted and acceptance is not revoked. The subsection applies both to defaults which occur at the inception of the lease and to defaults which occur subsequently, such as failure to comply with an obligation to maintain the leased goods. The measure in essence is the loss, in the ordinary course of events, flowing from the default.

5. Subsection (4), a revised version of the provisions of Section 2-714(2), states the measure of damages for breach of warranty. The measure in essence is the present value of the difference between the value of the goods accepted and of the goods if they had been as warranted.

6. Subsections (1), (3) and (4) specifically state that the parties may by contract vary the damages rules stated in those subsections.

Cross References:

Sections 2-713(1), 2-713(2), 2-714 and Section 2A-518.

Definitional Cross References:

"Conforming". Section 2A-103(1)(d).

"Delivery". Section 1-201(14).

"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notification". Section 1-201(26).
"Present value". Section 2A-103(1)(u).
"Value". Section 1-201(44).

4-2.5-520. Lessee's incidental and consequential damages. (1) Incidental damages resulting from a lessor's default include expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected or goods the acceptance of which is justifiably revoked, any commercially reasonable charges, expenses or commissions in connection with effecting cover, and any other reasonable expense incident to the default.

(2) Consequential damages resulting from a lessor's default include:

(a) Any loss resulting from general or particular requirements and needs of which the lessor at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) Injury to person or property proximately resulting from any breach of warranty.

Source: L. 91: Entire article added, p. 311, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-715.
Changes: Revised to reflect leasing terminology and practices.
Purposes:
Subsection (1), a revised version of the provisions of Section 2-715(1), lists some examples of incidental damages resulting from a lessor's default; the list is not exhaustive. Subsection (1) makes clear that it applies not only to rightful rejection, but also to justifiable revocation.
Subsection (2), a revised version of the provisions of Section 2-715(2), lists some examples of consequential damages resulting from a lessor's default; the list is not exhaustive.
Cross Reference:
Section 2-715.
Definitional Cross References:
"Goods". Section 2A-103(1)(h).
"Knows". Section 1-201(25).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Person". Section 1-201(30).
"Receipt". Section 2-103(1)(c).

4-2.5-521. Lessee's right to specific performance or replevin. (1) Specific performance may be decreed if the goods are unique or in other proper circumstances.

(2) A decree for specific performance may include any terms and conditions as to payment of the rent, damages, or other relief that the court deems just.

(3) A lessee has a right of replevin, detinue, sequestration, claim and delivery, or the like for goods identified to the lease contract if after reasonable effort the lessee is unable to effect cover for those goods or the circumstances reasonably indicate that the effort will be unavailing.

Source: L. 91: Entire article added, p. 312, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-716.
Changes: Revised to reflect leasing practices and terminology, and to expand the reference to the right of replevin in subsection (3) to include other similar rights of the lessee.
Definitional Cross References:
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Rights". Section 1-201(36).
"Term". Section 1-201(42).

4-2.5-522. Lessee's right to goods on lessor's insolvency. (1) Subject to subsection (2) of this section and even though the goods have not been shipped, a lessee who has paid a part or all of the rent and security for goods identified to a lease contract (section

4-2.5-217) on making and keeping good a tender of any unpaid portion of the rent and security due under the lease contract may recover the goods identified from the lessor if the lessor becomes insolvent within ten days after receipt of the first installment of rent and security.

(2) A lessee acquires the right to recover goods identified to a lease contract only if they conform to the lease contract.

Source: L. 91: Entire article added, p. 312, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-502.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Receipt". Section 2-103(1)(c).
"Rights". Section 1-201(36).

C. Default by Lessee

4-2.5-523. Lessor's remedies. (1) If a lessee wrongfully rejects or revokes acceptance of goods or fails to make a payment when due or repudiates with respect to a part or the whole, then, with respect to any goods involved, and with respect to all of the goods if under an installment lease contract the value of the whole lease contract is substantially impaired (section 4-2.5-510), the lessee is in default under the lease contract and the lessor may:

(a) Cancel the lease contract (section 4-2.5-505 (1));

(b) Proceed respecting goods not identified to the lease contract (section 4-2.5-524);

(c) Withhold delivery of the goods and take possession of goods previously delivered (section 4-2.5-525);

(d) Stop delivery of the goods by any bailee (section 4-2.5-526);

(e) Dispose of the goods and recover damages (section 4-2.5-527), or retain the goods and recover damages (section 4-2.5-528), or in a proper case recover rent (section 4-2.5-529);

(f) Exercise any other rights or pursue any other remedies provided in the lease contract.

(2) If a lessor does not fully exercise a right or obtain a remedy to which the lessor is entitled under subsection (1) of this section, the lessor may recover the loss resulting in the ordinary course of events from the lessee's default as determined in any reasonable manner, together with incidental damages, less expenses saved in consequence of the lessee's default.

(3) If a lessee is otherwise in default under a lease contract, the lessor may exercise the rights and pursue the remedies provided in the lease contract, which may include a right to cancel the lease. In addition, unless otherwise provided in the lease contract:

(a) If the default substantially impairs the value of the lease contract to the lessor, the lessor may exercise the rights and pursue the remedies provided in subsections (1) or (2) of this section; or

(b) If the default does not substantially impair the value of the lease contract to the lessor, the lessor may recover as provided in subsection (2) of this section.

Source: L. 91: Entire article added, p. 312, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-703.
Changes: Substantially revised.

Purposes:
1. Subsection (1) is an index to Sections

2A-524 through 2A-531 and states that the remedies provided in those sections are available for the defaults referred to in subsection (1): wrongful rejection or revocation of acceptance, failure to make a payment when due, or repudiation. In addition, remedies provided in the lease contract are available. Subsection (2) sets out a remedy if the lessor does not pursue to completion a right or actually obtain a remedy available under subsection (1), and subsection (3) sets out statutory remedies for defaults not specifically referred to in subsection (1). Subsection (3) provides that, if any default by the lessee other than those specifically referred to in subsection (1) is material, the lessor can exercise the remedies provided in subsection (1) or (2); otherwise the available remedy is as provided in subsection (3). A lessor who has brought an action seeking or has nonjudicially pursued one or more of the remedies available under subsection (1) may amend so as to claim or may nonjudicially pursue a remedy under subsection (2) unless the right or remedy first chosen has been pursued to an extent actually inconsistent with the new course of action. The intent of the provision is to reject the doctrine of election of remedies and to permit an alteration of course by the lessor unless such alteration would actually have an effect on the lessee that would be unreasonable under the circumstances. Further, the lessor may pursue remedies under both subsections (1) and (2) unless doing so would put the lessor in a better position than it would have been in had the lessee fully performed.

2. The lessor and the lessee can agree to modify the rights and remedies available under the Article; they can, among other things, provide that for defaults other than those specified in subsection (1) the lessor can exercise the rights and remedies referred to in subsection (1), whether or not the default would otherwise be held to substantially impair the value of the lease contract to the lessor; they can also create a new scheme of rights and remedies triggered by the occurrence of the default. Sections 2A-103(4) and 1-102(3).

3. Subsection (1), a substantially rewritten version of Section 2-703, lists various cumulative remedies of the lessor where the lessee wrongfully rejects or revokes acceptance, fails to make a payment when due, or repudiates. Section 2A-501(2) and (4). The subsection also allows the lessor to exercise any contractual remedy.

4. This Article rejects any general doctrine of election of remedy. Whether, in a particular case, one remedy bars another, is a function of whether lessor has been put in as good a position as if the lessee had fully performed the lease contract. Multiple remedies are barred only if the effect is to put the lessor in a better position than it would have been in had the lessee fully performed under the lease. Sections 2A-103(4), 2A-501(4), and 1-106(1).

5. **Hypothetical:** To better understand the application of subparagraphs (a) through (e), it is useful to review a hypothetical. Assume that A is a merchant in the business of selling and leasing new bicycles of various types. B is about to engage in the business of subleasing bicycles to summer residents of and visitors to an island resort. A, as lessor, has agreed to lease 60 bicycles to B. While there is one master lease, deliveries and terms are staggered. 20 bicycles are to be delivered by A to B's island location on June 1; the term of the lease of these bicycles is four months. 20 bicycles are to be delivered by A to B's island location on July 1; the term of the lease of these bicycles is three months. Finally, 20 bicycles are to be delivered by A to B's island location on August 1; the term of the lease of these bicycles is two months. B is obligated to pay rent to A on the 15th day of each month during the term for the lease. Rent is $50 per month, per bicycle. B has no option to purchase or release and must return the bicycles to A at the end of the term, in good condition, reasonable wear and tear excepted. Since the retail price of each bicycle is $400 and bicycles used in the retail rental business have a useful economic life of 36 months, this transaction creates a lease. Sections 2A-103(1)(j) and 1-201(37).

6. A's current inventory of bicycles is not large. Thus, upon signing the lease with B in February, A agreed to purchase 60 new bicycles from A's principal manufacturer, with special instructions to drop ship the bicycles to B's island location in accordance with the delivery schedule set forth in the lease.

7. The first shipment of 20 bicycles was received by B on May 21. B inspected the bicycles, accepted the same as conforming to the lease and signed a receipt of delivery and acceptance. However, due to poor weather that summer, business was terrible and B was unable to pay the rent due on June 15. Pursuant to the lease A sent B notice of default and proceeded to enforce his rights and remedies against B.

8. A's counsel first advised A that under Section 2A-510(2) and the terms of the lease B's failure to pay was a default with respect to the whole. Thus, to minimize A's continued exposure, A was advised to take possession of the bicycles. If A had possession of the goods A could refuse to deliver. Section 2A-525(1). However, the facts here are different. With respect to the bicycles in B's possession, A has the right to take possession of the bicycles, without breach of the peace. Section 2A-525(2). If B refuses to allow A access to the bicycles, A can proceed by action, including replevin or injunctive relief.

9. With respect to the 40 bicycles that have not been delivered, this Article provides various alternatives. First, assume that 20 of the remain-

ing 40 bicycles have been manufactured and delivered by the manufacturer to a carrier for shipment to B. Given the size of the shipment, the carrier was using a small truck for the delivery and the truck had not yet reached the island ferry when the manufacturer (at the request of A) instructed the carrier to divert the shipment to A's place of business. A's right to stop delivery is recognized under these circumstances. Section 2A- 526(1). Second, assume that the 20 remaining bicycles were in the process of manufacture when B defaulted. A retains the right (as between A as lessor and B as lessee) to exercise reasonable commercial judgment whether to complete manufacture or to dispose of the unfinished goods for scrap. Since A is not the manufacturer and A has a binding contract to buy the bicycles, A elected to allow the manufacturer to complete the manufacture of the bicycles, but instructed the manufacturer to deliver the completed bicycles to A's place of business. Section 2A-524(2).

10. Thus, so far A has elected to exercise the remedies referred to in subparagraphs (b) through (d) in subsection (1). None of these remedies bars any of the others because A's election and enforcement merely resulted in A's possession of the bicycles. Had B performed A would have recovered possession of the bicycles. Thus A is in the process of obtaining the benefit of his bargain. Note that A could exercise any other rights or pursue any other remedies provided in the lease contract (Section 2A-523(1)(f)), or elect to recover his loss due to the lessee's default under Section 2A-523(2).

11. A's counsel next would determine what action, if any, should be taken with respect to the goods. As stated in subparagraph (e) and as discussed fully in Section 2A-527(1) the lessor may, but has no obligation to, dispose of the goods by a substantially similar lease (indeed, the lessor has no obligation whatsoever to dispose of the goods at all) and recover damages based on that action, but lessor will not be able to recover damages which put it in a better position than performance would have done, nor will it be able to recover damages for losses which it could have reasonably avoided. In this case, since A is in the business of leasing and selling bicycles, A will probably inventory the 60 bicycles for its retail trade.

12. A's counsel then will determine which of the various means of ascertaining A's damages against B are available. Subparagraph (e) catalogues each relevant section. First, under Section 2A-527(2) the amount of A's claim is computed by comparing the original lease between A and B with any subsequent lease of the bicycles but only if the subsequent lease is substantially similar to the original lease contract. While the section does not define this term, the official comment does establish some parameters. If, however, A elects to lease the bicycles to his retail trade, it is unlikely that the resulting lease will be substantially similar to the original, as leases to retail customers are considerably different from leases to wholesale customers like B. If, however, the leases were substantially similar, the damage claim is for accrued and unpaid rent to the beginning of the new lease, plus the present value as of the same date, of the rent reserved under both the original lease for the balance of its term less the present value as of the same date of the rent reserved under the replacement lease for a term comparable to the balance of the term of the original lease, together with incidental damages less expenses saved in consequence of the lessee's default.

13. If the new lease is not substantially similar or if A elects to sell the bicycles or to hold the bicycles, damages are computed under Section 2A-528 or 2A-529.

14. If A elects to pursue his claim under Section 2A-528(1) the damage rule is the same as that stated in Section 2A-527(2) except that damages are measured from default if the lessee never took possession of the goods or from the time when the lessor did or could have regained possession and that the standard of comparison is not the rent reserved under a substantially similar lease entered into by the lessor but a market rent, as defined in Section 2A-507. Further, if the facts of this hypothetical were more elaborate A may be able to establish that the measure of damage under subsection (1) is inadequate to put him in the same position that B's performance would have, in which case A can claim the present value of his lost profits.

15. Yet another alternative for computing A's damage claim against B which will be available in some situations is recovery of the present value, as of entry of judgment, of the rent for the then remaining lease term under Section 2A-529. However, this formulation is not available if the goods have been repossessed or tendered back to A. For the 20 bicycles repossessed and the remaining 40 bicycles, A will be able to recover the present value of the rent only if A is unable to dispose of them, or circumstances indicate the effort will be unavailing. If A has prevailed in an action for the rent, at any time up to collection of a judgment by A against B, A might dispose of the bicycles. In such case A's claim for damages against B is governed by Section 2A-527 or 2A-528. Section 2A-529(3). The resulting recalculation of claim should reduce the amount recoverable by A against B and the lessor is required to cause an appropriate credit to be entered against the earlier judgment. However, the nature of the post- judgment proceedings to resolve this issue, and the sanctions for a failure to comply, if any, will be determined by other law.

16. Finally, if the lease agreement had so provided pursuant to subparagraph (f), A's

claim against B would not be determined under any of these statutory formulae, but pursuant to a liquidated damages clause. Section 2A-504(1).

17. These various methods of computing A's damage claim against B are alternatives subject to Section 2A-501(4). However, the pursuit of any one of these alternatives is not a bar to, nor has it been barred by, A's earlier action to obtain possession of the 60 bicycles. These formulae, which vary as a function of an overt or implied mitigation of damage theory, focus on allowing A a recovery of the benefit of his bargain with B. Had B performed, A would have received the rent as well as the return of the 60 bicycles at the end of the term.

18. Finally, A's counsel should also advise A of his right to cancel the lease contract under subparagraph (a). Section 2A-505(1). Cancellation will discharge all existing obligations but preserve A's rights and remedies.

19. Subsection (2) recognizes that a lessor who is entitled to exercise the rights or to obtain a remedy granted by subsection (1) may choose not to do so. In such cases, the lessor can recover damages as provided in subsection (2). For example, for non-payment of rent, the lessor may decide not to take possession of the goods and cancel the lease, but rather to merely sue for the unpaid rent as it comes due plus lost interest or other damages "determined in any reasonable manner." Subsection (2) also negates any loss of alternative rights and remedies by reason of having invoked or commenced the exercise or pursuit of any one or more rights or remedies.

20. Subsection (3) allows the lessor access to a remedy scheme provided in this Article as well as that contained in the lease contract if the lessee is in default for reasons other than those stated in subsection (1). Note that the reference to this Article includes supplementary principles of law and equity, e.g., fraud, misrepresentation and duress. Sections 2A-103(4) and 1-103.

21. There is no special treatment of the finance lease in this section. Absent supplementary principles of law to the contrary, in most cases the supplier will have no rights or remedies against the defaulting lessee. Section 2A-209(2)(ii). Given that the supplier will look to the lessor for payment, this is appropriate. However, there is a specific exception to this rule with respect to the right to identify goods to the lease contract. Section 2A-524(2). The parties are free to create a different result in a particular case. Sections 2A-103(4) and 1-102(3).

Cross References:

Sections 1-102(3), 1-103, 1-106(1), 1-201(37), 2-703, 2A-103(1)(j), 2A-103(4), 2A-209(2)(ii), 2A-501(4), 2A-504(1), 2A-505(1), 2A-507, 2A-510(2), 2A-524 through 2A-531, 2A-524(2), 2A-525(1), 2A-525(2), 2A-526(1), 2A-527(1), 2A-527(2), 2A-528(1) and 2A-529(3).

Definitional Cross References:

"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Installment lease contract". Section 2A-103(1)(i).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).
"Value". Section 1-201(44).

4-2.5-524. Lessor's right to identify goods to lease contract. (1) A lessor aggrieved under section 4-2.5-523 (1) may:

(a) Identify to the lease contract conforming goods not already identified if at the time the lessor learned of the default they were in the lessor's or the supplier's possession or control; and

(b) Dispose of goods (section 4-2.5-527 (1)) that demonstrably have been intended for the particular lease contract even though those goods are unfinished.

(2) If the goods are unfinished, in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization, an aggrieved lessor or the supplier may either complete manufacture and wholly identify the goods to the lease contract or cease manufacture and lease, sell, or otherwise dispose of the goods for scrap or salvage value or proceed in any other reasonable manner.

Source: L. 91: Entire article added, p. 313, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-704.
Changes: Revised to reflect leasing practices and terminology.
Purposes: The remedies provided by this section are available to the lessor (i) if there has been a default by the lessee which falls within Section 2A-523(1) or 2A-523(3)(a), or (ii) if there has been any other default for which the lease contract gives the lessor the remedies provided by this section. Under "(ii)", the lease contract may give the lessor the remedies of identification and disposition provided by this

section in various ways. For example, a lease provision might specifically refer to the remedies of identification and disposition, or it might refer to this section by number (i.e., 2A-524), or it might do so by a more general reference such as "all rights and remedies provided by Article 2A for default by the lessee."

Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Learn". Section 1-201(25).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessor". Section 2A-103(1)(p).
"Rights". Section 1-201(36).
"Supplier". Section 2A-103(1)(x).
"Value". Section 1-201(44).

4-2.5-525. Lessor's right to possession of goods. (1) If a lessor discovers the lessee to be insolvent, the lessor may refuse to deliver the goods.

(2) After a default by the lessee under the lease contract of the type described in section 4-2.5-523 (1) or 4-2.5-523 (3) (a) or, if agreed, after other default by the lessee, the lessor has the right to take possession of the goods. If the lease contract so provides, the lessor may require the lessee to assemble the goods and make them available to the lessor at a place to be designated by the lessor which is reasonably convenient to both parties. Without removal, the lessor may render unusable any goods employed in trade or business, and may dispose of goods on the lessee's premises (section 4-2.5-527).

(3) The lessor may proceed under subsection (2) of this section without judicial process if it can be done without breach of the peace or the lessor may proceed by action.

Source: L. 91: Entire article added, p. 314, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Sections 2-702(1) and 9-503.

Changes: Substantially revised.

Purposes:

1. Subsection (1), a revised version of the provisions of Section 2-702(1), allows the lessor to refuse to deliver goods if the lessee is insolvent. Note that the provisions of Section 2-702(2), granting the unpaid seller certain rights of reclamation, were not incorporated in this section. Subsection (2) made this unnecessary.

2. Subsection (2), a revised version of the provisions of Section 9-503, allows the lessor, on a Section 2A-523(1) or 2A-523(3)(a) default by the lessee, the right to take possession of or reclaim the goods. Also, the lessor can contract for the right to take possession of the goods for other defaults by the lessee. Therefore, since the lessee's insolvency is an event of default in a standard lease agreement, subsection (2) is the functional equivalent of Section 2-702(2). Further, subsection (2) sanctions the classic crate and delivery clause obligating the lessee to assemble the goods and to make them available to the lessor. Finally, the lessor may leave the goods in place, render them unusable (if they are goods employed in trade or business), and dispose of them on the lessee's premises.

3. Subsection (3), a revised version of the provisions of Section 9-503, allows the lessor to proceed under subsection (2) without judicial process, absent breach of the peace, or by action. Sections 2A-501(3), 2A-103(4) and 1-201(1). In the appropriate case action includes injunctive relief. Clark Equip. Co. v. Armstrong Equip. Co., 431 F.2d 54 (5th Cir. 1970), cert. denied, 402 U.S. 909 (1971). This Section, as well as a number of other Sections in this Part, are included in the Article to codify the lessor's common law right to protect the lessor's reversionary interest in the goods. Section 2A-103(1)(q). These Sections are intended to supplement and not displace principles of law and equity with respect to the protection of such interest. Sections 2A-103(4) and 1-103. Such principles apply in many instances, e.g., loss or damage to goods if risk of loss passes to the lessee, failure of the lessee to return goods to the lessor in the condition stipulated in the lease, and refusal of the lessee to return goods to the lessor after termination or cancellation of the lease. See also Section 2A-532.

Cross References:

Sections 1-106(2), 2-702(1), 2-702(2), 2A-103(4), 2A-501(3), 2A-532 and 9-503.

Definitional Cross References:

"Action". Section 1-201(1).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).

4-2.5-526. Lessor's stoppage of delivery in transit or otherwise. (1) A lessor may stop delivery of goods in the possession of a carrier or other bailee if the lessor discovers the lessee to be insolvent and may stop delivery of carload, truckload, planeload, or larger shipments of express or freight if the lessee repudiates or fails to make a payment due before delivery, whether for rent, security or otherwise under the lease contract, or for any other reason the lessor has a right to withhold or take possession of the goods.

(2) In pursuing its remedies under subsection (1) of this section, the lessor may stop delivery until:

(a) Receipt of the goods by the lessee;

(b) Acknowledgment to the lessee by any bailee of the goods, except a carrier, that the bailee holds the goods for the lessee; or

(c) Such an acknowledgment to the lessee by a carrier via reshipment or as a warehouse.

(3) (a) To stop delivery, a lessor shall so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After notification, the bailee shall hold and deliver the goods according to the directions of the lessor, but the lessor is liable to the bailee for any ensuing charges or damages.

(c) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

Source: L. 91: Entire article added, p. 314, § 1, effective July 1, 1992. **L. 2006:** (2) amended, p. 494, § 21, effective September 1.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-705.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Bill of lading". Section 1-201(6).
"Delivery". Section 1-201(14).
"Discover". Section 1-201(25).
"Goods". Section 2A-103(1)(h).
"Insolvent". Section 1-201(23).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Notifies" and "Notification". Section 1-201(26).
"Person". Section 1-201(30).
"Receipt". Section 2-103(1)(c).
"Remedy". Section 1-201(34).
"Rights". Section 1-201(36).

4-2.5-527. Lessor's rights to dispose of goods. (1) After a default by a lessee under the lease contract of the type described in section 4-2.5-523 (1) or 4-2.5-523 (3) (a) or after the lessor refuses to deliver or takes possession of goods (section 4-2.5-525 or 4-2.5-526), or if agreed, after other default by a lessee, the lessor may dispose of the goods concerned or the undelivered balance thereof by lease, sale, or otherwise.

(2) Except as otherwise provided with respect to damages liquidated in the lease agreement (section 4-2.5-504) or otherwise determined pursuant to agreement of the parties (sections 4-1-302 and 4-2.5-503), if the disposition is by lease agreement substantially similar to the original lease agreement and the lease agreement is made in good faith and in a commercially reasonable manner, the lessor may recover from the lessee as damages (i) accrued and unpaid rent as of the date of the commencement of the term of the new lease agreement, (ii) the present value, as of the same date, of the total rent for the then remaining lease term of the original lease agreement minus the present value, as of the same date, of the rent under the new lease agreement applicable to that period of the new lease term that is comparable to the then remaining term of the original lease agreement, (iii) interest on the amount computed under clause (ii) of this subsection (2) from the date of the commencement of the term of the new lease agreement until the date of entry of judgment at the same rate used in computing present value, and (iv) any incidental damages allowed under section 4-2.5-530, less expenses saved in consequence of the lessee's default.

(3) If the lessor's disposition is by lease agreement that for any reason does not qualify for treatment under subsection (2) of this section, or is by sale or otherwise, the lessor may

recover from the lessee as if the lessor had elected not to dispose of the goods and section 4-2.5-528 governs.

(4) A subsequent buyer or lessee who buys or leases from the lessor in good faith for value as a result of a disposition under this section takes the goods free of the original lease contract and any rights of the original lessee even though the lessor fails to comply with one or more of the requirements of this article.

(5) The lessor is not accountable to the lessee for any profit made on any disposition. A lessee who has rightfully rejected or justifiably revoked acceptance shall account to the lessor for any excess over the amount of the lessee's security interest (section 4-2.5-508 (5)).

Source: L. 91: Entire article added, p. 315, § 1, effective July 1, 1992. **L. 2006:** (2) amended, p. 495, § 22, effective September 1.

Editor's note - Colorado legislative change. In subsection (2) of this section, after the words "term of the original lease agreement,", Colorado inserted a new clause as follows: "(iii) interest on the amount computed under clause (ii) of this subsection (2) from the date of the commencement of the term of the new lease agreement until the date of entry of judgment at the same rate used in computing present value,". The third clause was then relettered as clause "(iv)".

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-706(1), (5) and (6).

Changes: Substantially revised.

Purposes:

1. Subsection (1), a revised version of the first sentence of subsection 2-706(1), allows the lessor the right to dispose of goods after a statutory or other material default by the lessee (even if the goods remain in the lessee's possession - Section 2A-525(2)), after the lessor refuses to deliver or takes possession of the goods, or, if agreed, after other contractual default. The lessor's decision to exercise this right is a function of a commercial judgment, not a statutory mandate replete with sanctions for failure to comply. Cf. Section 9-507. As the owner of the goods, in the case of a lessor, or as the prime lessee of the goods, in the case of a sublessor, compulsory disposition of the goods is inconsistent with the nature of the interest held by the lessor or the sublessor and is not necessary because the interest held by the lessee or the sublessee is not protected by a right of redemption under the common law or this Article. Subsection 2A-527(5).

2. The rule for determining the measure of damages recoverable by the lessor against the lessee is a function of several variables. If the lessor has elected to effect disposition under subsection (1) and such disposition is by lease that qualifies under subsection (2), the measure of damages set forth in subsection (2) will apply, absent agreement to the contrary. Sections 2A-504, 2A-103(4) and 1-102(3).

3. The lessor's damages will be established using the new lease agreement as a measure if the following three criteria are satisfied: (i) the lessor disposed of the goods by lease, (ii) the lease agreement is substantially similar to the original lease agreement, and (iii) such disposition was in good faith, and in a commercially reasonable manner. Thus, the lessor will be entitled to recover from the lessee the accrued and unpaid rent as of the date of commencement of the term of the new lease, and the present value, as of the same date, of the rent under the original lease for the then remaining term less the present value as of the same date of the rent under the new lease agreement applicable to the period of the new lease comparable to the remaining term under the original lease, together with incidental damages less expenses saved in consequence of the lessee's default. If the lessor's disposition does not satisfy the criteria of subsection (2), the lessor may calculate its claim against the lessee pursuant to Section 2A-528. Section 2A-523(1)(e).

4. Two of the three criteria to be met by the lessor are familiar, but the concept of the new lease agreement that is substantially similar to the original lease agreement is not. Given the many variables facing a party who intends to lease goods and the rapidity of change in the market place, the policy decision was made not to draft with specificity. It was thought unwise to seek to establish certainty at the cost of fairness. The decision of whether the new lease agreement is substantially similar to the original will be determined case by case.

5. While the section does not draw a bright line, it is possible to describe some of the factors that should be considered in a finding that a new lease agreement is substantially similar to the original. The various elements of the new lease agreement should be examined. Those elements include the options to purchase or release; the lessor's representations, warranties and covenants to the lessee as well as those to be

provided by the lessee to the lessor; and the services, if any, to be provided by the lessor or by the lessee. All of these factors allocate cost and risk between the lessor and the lessee and thus affect the amount of rent to be paid. These findings should not be made with scientific precision, as they are a function of economics, nor should they be made independently, as it is important that a sense of commercial judgment pervade the finding. See Section 2A-507(2). To establish the new lease as a proper measure of damage under subsection (2), these various factors, taken as a whole, must result in a finding that the new lease agreement is substantially similar to the original. If the differences between the original lease and the new lease can be easily valued, it would be appropriate for a court to find that the new lease is substantially similar to the old lease, adjust the difference in the rent between the two leases to take account of the differences, and award damages under this section. If, for example, the new lease requires the lessor to insure the goods in the hands of the lessee, while the original lease required the lessee to insure, the usual cost of such insurance could be deducted from rent due under the new lease before the difference in rental between the two leases is determined.

6. The following hypothetical illustrates the difficulty of providing a bright line. Assume that A buys a jumbo tractor for $1 million and then leases the tractor to B for a term of 36 months. The tractor is delivered to and is accepted by B on May 1. On June 1 B fails to pay the monthly rent to A. B returns the tractor to A, who immediately releases the tractor to C for a term identical to the term remaining under the lease between A and B. All terms and conditions under the lease between A and C are identical to those under the original lease between A and B, except that C does not provide any property damage or other insurance coverage, and B agreed to provide complete coverage. Coverage is expensive and difficult to obtain. It is a question of fact whether it is so difficult to adjust the recovery to take account of the difference between the two leases as to insurance that the second lease is not substantially similar to the original.

7. A new lease can be substantially similar to the original lease even though its term extends beyond the remaining term of the original lease, so long as both (a) the lease terms are commercially comparable (e.g., it is highly unlikely that a one-month rental and a five-year lease would reflect similar realities), and (b) the court can fairly apportion a part of the rental payments under the new lease to that part of the term of the new lease which is comparable to the remaining lease term under the original lease. Also, the lease term of the new lease may be comparable to the remaining term of the original lease even though the beginning and ending dates of the two leases are not the same. For example, a two-month lease of agricultural equipment for the months of August and September may be comparable to a two-month lease running from the 15th of August to the 15th of October if in the particular location two-month leases beginning on August 15th are basically interchangeable with two-month leases beginning August 1st. Similarly, the term of a one-year truck lease beginning on the 15th of January may be comparable to the term of a one-year truck lease beginning January 2d. If the lease terms are found to be comparable, the court may base cover damages on the entire difference between the costs under the two leases.

8. Subsection (3), which is new, provides that if the lessor's disposition is by lease that does not qualify under subsection (2), or is by sale or otherwise, Section 2A-528 governs.

9. Subsection (4), a revised version of subsection 2-706(5), applies to protect a subsequent buyer or lessee who buys or leases from the lessor in good faith and for value, pursuant to a disposition under this section. Note that by its terms, the rule in subsection 2A-304(1), which provides that the subsequent lessee takes subject to the original lease contract, is controlled by the rule stated in this subsection.

10. Subsection (5), a revised version of subsection 2-706(6), provides that the lessor is not accountable to the lessee for any profit made by the lessor on a disposition. This rule follows from the fundamental premise of the bailment for hire that the lessee under a lease of goods has no equity of redemption to protect.

Cross References:

Sections 1-102(3), 2-706(1), 2-706(5), 2-706(6), 2A-103(4), 2A-304(1), 2A-504, 2A-507(2), 2A-523(1)(e), 2A-525(2), 2A-527(5), 2A-528 and 9-507.

Definitional Cross References:

"Buyer" and "Buying". Section 2-103(1)(a).
"Delivery". Section 1-201(14).
"Good faith". Sections 1-201(19) and 2-103(1)(b).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Present value". Section 2A-103(1)(u).
"Rights". Section 1-201(36).
"Sale". Section 2-106(1).
"Security interest". Section 1-201(37).
"Value". Section 1-201(44).

4-2.5-528. Lessor's damages for nonacceptance, failure to pay, repudiation, or other default. (1) Except as otherwise provided with respect to damages liquidated in the lease agreement (section 4-2.5-504) or otherwise determined pursuant to agreement of the

parties (sections 4-1-302 and 4-2.5-503), if a lessor elects to retain the goods or a lessor elects to dispose of the goods and the disposition is by lease agreement that for any reason does not qualify for treatment under section 4-2.5-527 (2), or is by sale or otherwise, the lessor may recover from the lessee as damages for a default of the type described in section 4-2.5-523 (1) or 4-2.5-523 (3) (a), or, if agreed, for other default of the lessee, (i) accrued and unpaid rent as of the date of default if the lessee has never taken possession of the goods, or, if the lessee has taken possession of the goods, as of the date the lessor repossesses the goods or an earlier date on which the lessee makes a tender of the goods to the lessor, (ii) the present value as of the date determined under clause (i) of the total rent for the then remaining lease term of the original lease agreement minus the present value as of the same date of the market rent at the place where the goods are located computed for the same lease term, (iii) interest on the sum of the amounts described in clauses (i) and (ii) of this subsection (1) from the date of default to the date of entry of judgment at the same rate used in computing present value, and (iv) any incidental damages allowed under section 4-2.5-530, less expenses saved in consequence of the lessee's default.

(2) At his or her option, the lessor may recover from the lessee as damages for a default of the type described in subsection (1) of this section, in lieu of the damages recoverable under said subsection (1), the present value of the profit, including reasonable overhead, the lessor would have made from full performance by the lessee, together with any incidental damages allowed under section 4-2.5-530, due allowance for costs reasonably incurred and due credit for payments or proceeds of disposition.

Source: L. 91: Entire article added, p. 316, § 1, effective July 1, 1992. **L. 2006:** (1) amended, p. 495, § 23, effective September 1.

Editor's note: Colorado legislative changes. (1) In subsection (1) of this section, after the words "the same lease term,", Colorado inserted a new clause as follows: "(iii) interest on the sum of the amounts described in clauses (i) and (ii) of this subsection (1) from the date of default to the date of entry of judgment at the same rate used in computing present value,". The third clause was then relettered as clause "(iv)".

(2) In subsection (2) of this section, Colorado deleted the words "If the measure of damages provided in subsection (1) is inadequate to put a lessor in as good a position as performance would have, the measure of damages is" and substituted the words "At his or her option, the lessor may recover from the lessee as damages for a default of the type described in subsection (1) of this section, in lieu of the damages recoverable under said subsection (1),".

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-708.
Changes: Substantially revised.
Purposes:

1. Subsection (1), a substantially revised version of Section 2-708(1), states the basic rule governing the measure of lessor's damages for a default described in Section 2A-523(1) or (3)(a), and, if agreed, for a contractual default. This measure will apply if the lessor elects to retain the goods (whether undelivered, returned by the lessee, or repossessed by the lessor after acceptance and default by the lessee) or if the lessor's disposition does not qualify under subsection 2A-527(2). Section 2A-527(3). Note that under some of these conditions, the lessor may recover damages from the lessee pursuant to the rule set forth in Section 2A-529. There is no sanction for disposition that does not qualify under subsection 2A-527(2). Application of the rule set forth in this section is subject to agreement to the contrary. Sections 2A-504, 2A-103(4) and 1-102(3).

2. If the lessee has never taken possession of the goods, the measure of damage is the accrued and unpaid rent as of the date of default together with the present value, as of the date of default, of the original rent for the remaining term of the lease less the present value as of the same date of market rent, and incidental damages, less expenses saved in consequence of the default. Note that the reference in Section 2A-528(1)(i) and (ii) is to the date of default not to the date of an event of default. An event of default under a lease agreement becomes a default under a lease agreement only after the expiration of any relevant period of grace and compliance with any notice requirements under this Article and the lease agreement. American Bar Foundation, Commentaries on Indentures, . 5-1, at 216-217 (1971). Section 2A-501(1). This conclusion is also a function of whether, as a matter of fact or law, the event of default has been waived, suspended or cured. Sections 2A-103(4) and 1-103. If the lessee has taken pos-

session of the goods, the measure of damages is the accrued and unpaid rent as of the earlier of the time the lessor repossesses the goods or the time the lessee tenders the goods to the lessor plus the difference between the present value, as of the same time, of the rent under the lease for the remaining lease term and the present value, as of the same time, of the market rent.

3. Market rent will be computed pursuant to Section 2A-507.

4. Subsection (2), a somewhat revised version of the provisions of subsection 2-708(2), states a measure of damages which applies if the measure of damages in subsection (1) is inadequate to put the lessor in as good a position as performance would have. The measure of damage is the lessor's profit, including overhead, together with incidental damages, with allowance for costs reasonably incurred and credit for payments or proceeds of disposition. In determining the amount of due credit with respect to proceeds of disposition a proper value should be attributed to the lessor's residual interest in the goods. Sections 2A-103(1)(q) and 2A-507(4).

5. In calculating profit, a court should include any expected appreciation of the goods, e.g. the foal of a leased brood mare. Because this subsection is intended to give the lessor the benefit of the bargain, a court should consider any reasonable benefit or profit expected by the lessor from the performance of the lease agreement. See Honeywell, Inc. v. Lithonia Lighting, Inc., 317 F. Supp. 406, 413 (N.D. Ga. 1970); Locks v. Wade, 36 N.J. Super. 128, 131, 114 A.2d 875, 877 (Super. Ct. App. Div. 1955). Further, in calculating profit the concept of present value must be given effect. Taylor v. Commercial Credit Equip. Corp., 170 Ga. App. 322, 316 S.E.2d 788 (Ct. App. 1984). See generally Section 2A-103(1)(u).

Cross References:

Sections 1-102(3), 2-708, 2A-103(1)(u), 2A-402, 2A-504, 2A-507, 2A-527(2) and 2A-529.

Definitional Cross References:

"Agreement". Section 1-201(3).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Present value". Section 2A-103(1)(u).
"Sale". Section 2-106(1).

4-2.5-529. Lessor's action for the rent. (1) After default by the lessee under the lease contract of the type described in section 4-2.5-523 (1), or 4-2.5-523 (3) (a) or, if agreed, after other default by the lessee, if the lessor complies with subsection (2) of this section, the lessor may recover from the lessee as damages:

(a) For goods accepted by the lessee and not repossessed by or tendered to the lessor, and for conforming goods lost or damaged within a commercially reasonable time after risk of loss passes to the lessee (section 4-2.5-219), (i) accrued and unpaid rent as of the date of entry of judgment in favor of the lessor, (ii) the present value as of the same date of the total rent for the then remaining lease term of the lease agreement, and (iii) any incidental damages allowed under section 4-2.5-530, less expenses saved in consequence of the lessee's default; and

(b) For goods identified to the lease contract if the lessor is unable after reasonable effort to dispose of them at a reasonable price or the circumstances reasonably indicate that effort will be unavailing, (i) accrued and unpaid rent as of the date of entry of judgment in favor of the lessor, (ii) the present value as of the same date of the rent for the then remaining lease term of the lease agreement, and (iii) any incidental damages allowed under section 4-2.5-530, less expenses saved in consequence of the lessee's default.

(2) Except as provided in subsection (3) of this section, the lessor shall hold for the lessee for the remaining lease term of the lease agreement any goods that have been identified to the lease contract and are in the lessor's control.

(3) The lessor may dispose of the goods at any time before collection of the judgment for damages obtained pursuant to subsection (1) of this section. If the disposition is before the end of the remaining lease term of the lease agreement, the lessor's recovery against the lessee for damages is governed by section 4-2.5-527 or section 4-2.5-528 and the lessor will cause an appropriate credit to be provided against a judgment for damages to the extent that the amount of the judgment exceeds the recovery available pursuant to section 4-2.5-527 or 4-2.5-528.

(4) Payment of the judgment for damages obtained pursuant to subsection (1) of this section entitles the lessee to the use and possession of the goods not then disposed of for the remaining lease term of and in accordance with the lease agreement.

(5) After a lessee has wrongfully rejected or revoked acceptance of goods, has failed to

pay rent then due, or has repudiated (section 4-2.5-402), a lessor who is held not entitled to rent under this section must nevertheless be awarded damages for non-acceptance under sections 4-2.5-527 and 4-2.5-528.

Source: L. 91: Entire article added, p. 316, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-709.
Changes: Substantially revised.
Purposes:

1. Absent a lease contract provision to the contrary, an action for the full unpaid rent (discounted to present value as of the time of entry of judgment as to rent due after that time) is available as to goods not lost or damaged only if the lessee retains possession of the goods or the lessor is or apparently will be unable to dispose of them at a reasonable price after reasonable effort. There is no general right in a lessor to recover the full rent from the lessee upon holding the goods for the lessee. If the lessee tenders goods back to the lessor, and the lessor refuses to accept the tender, the lessor will be limited to the damages it would have suffered had it taken back the goods. The rule in Article 2 that the seller can recover the price of accepted goods is rejected here. In a lease, the lessor always has a residual interest in the goods which the lessor usually realizes upon at the end of a lease term by either sale or a new lease. Therefore, it is not a substantial imposition on the lessor to require it to take back and dispose of the goods if the lessee chooses to tender them back before the end of the lease term: the lessor will merely do earlier what it would have done anyway, sell or relet the goods. Further, the lessee will frequently encounter substantial difficulties if the lessee attempts to sublet the goods for the remainder of the lease term. In contrast to the buyer who owns the entire interest in goods and can easily dispose of them, the lessee is selling only the right to use the goods under the terms of the lease and the sublessee must assume a relationship with the lessor. In that situation, it is usually more efficient to eliminate the original lessee as a middleman by allowing the lessee to return the goods to the lessor who can then redispose of them.

2. In some situations even where possession of the goods is reacquired, a lessor will be able to recover as damages the present value of the full rent due, not under this section, but under 2A-528(2) which allows a lost profit recovery if necessary to put the lessor in the position it would have been in had the lessee performed. Following is an example of such a case. A is a lessor of construction equipment and maintains a substantial inventory. B leases from A a backhoe for a period of two weeks at a rental of $1,000. After three days, B returns the backhoe and refuses to pay the rent. A has five backhoes in inventory, including the one returned by B. During the next 11 days after the return by B of the backhoe, A rents no more than three backhoes at any one time and, therefore, always has two on hand. If B had kept the backhoe for the full rental period, A would have earned the full rental on that backhoe, plus the rental on the other backhoes it actually did rent during that period. Getting this backhoe back before the end of the lease term did not enable A to make any leases it would not otherwise have made. The only way to put A in the position it would have been in had the lessee fully performed is to give the lessor the full rentals. A realized no savings at all because the backhoe was returned early and might even have incurred additional expense if it was paying for parking space for equipment in inventory. A has no obligation to relet the backhoe for the benefit of B rather than leasing that backhoe or any other in inventory for its own benefit. Further, it is probably not reasonable to expect A to dispose of the backhoe by sale when it is returned in an effort to reduce damages suffered by B. Ordinarily, the loss of a two-week rental would not require A to reduce the size of its backhoe inventory. Whether A would similarly be entitled to full rentals as lost profit in a one-year lease of a backhoe is a question of fact: in any event the lessor, subject to mitigation of damages rules, is entitled to be put in as good a position as it would have been had the lessee fully performed the lease contract.

3. Under subsection (2) a lessor who is able and elects to sue for the rent due under a lease must hold goods not lost or damaged for the lessee. Subsection (3) creates an exception to the subsection (2) requirement. If the lessor disposes of those goods prior to collection of the judgment (whether as a matter of law or agreement), the lessor's recovery is governed by the measure of damages in Section 2A-527 if the disposition is by lease that is substantially similar to the original lease, or otherwise by the measure of damages in Section 2A-528. Section 2A-523 official comment.

4. Subsection (4), which is new, further reinforces the requisites of Subsection (2). In the event the judgment for damages obtained by the lessor against the lessee pursuant to subsection (1) is satisfied, the lessee regains the right to use and possession of the remaining goods for the balance of the original lease term; a partial satisfaction of the judgment creates no right in the lessee to use and possession of the goods.

5. The relationship between subsections (2) and (4) is important to understand. Subsection (2) requires the lessor to hold for the lessee identified goods in the lessor's possession. Absent agreement to the contrary, whether in the lease or otherwise, under most circumstances the requirement that the lessor hold the goods for the lessee for the term will mean that the lessor is not allowed to use them. Sections 2A-103(4) and 1-203. Further, the lessor's use of the goods could be viewed as a disposition of the goods that would bar the lessor from recovery under this section, remitting the lessor to the two preceding sections for a determination of the lessor's claim for damages against the lessee.

6. Subsection (5), the analogue of subsection 2- 709(3), further reinforces the thrust of subsection (3) by stating that a lessor who is held not entitled to rent under this section has not elected a remedy; the lessor must be awarded damages under Sections 2A-527 and 2A-528. This is a function of two significant policies of this Article - that resort to a remedy is optional, unless expressly agreed to be exclusive (Section 2A-503(2)) and that rights and remedies provided in this Article generally are cumulative. (Section 2A-501(2) and (4)).

Cross References:

Sections 1-203, 2-709, 2-709(3), 2A-103(4), 2A-501(2), 2A-501(4), 2A-503(2), 2A-504, 2A-523(1)(e), 2A-525(2), 2A-527, 2A-528 and 2A-529(2).

Definitional Cross References:

"Action". Section 1-201(1).
"Conforming". Section 2A-103(1)(d).
"Goods". Section 2A-103(1)(h).
"Lease". Section 2A-103(1)(j).
"Lease agreement". Section 2A-103(1)(k).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Present value". Section 2A-103(1)(u).
"Reasonable time". Section 1-204(1) and (2).

4-2.5-530. Lessor's incidental damages. Incidental damages to an aggrieved lessor include any commercially reasonable charges, expenses, or commissions incurred in stopping delivery, in the transportation, care, and custody of goods after the lessee's default, in connection with return or disposition of the goods, or otherwise resulting from the default.

Source: L. 91: Entire article added, p. 318, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-710.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:

"Aggrieved party". Section 1-201(2).
"Delivery". Section 1-201(14).
"Goods". Section 2A-103(1)(h).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).

4-2.5-531. Standing to sue third parties for injury to goods. (1) If a third party so deals with goods that have been identified to a lease contract as to cause actionable injury to a party to the lease contract (a) the lessor has a right of action against the third party, and (b) the lessee also has a right of action against the third party if the lessee:

(i) Has a security interest in the goods;

(ii) Has an insurable interest in the goods; or

(iii) Bears the risk of loss under the lease contract or has since the injury assumed that risk as against the lessor and the goods have been converted or destroyed.

(2) If at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the lease contract and there is no arrangement between them for disposition of the recovery, his or her suit or settlement, subject to his or her own interest, is as a fiduciary for the other party to the lease contract.

(3) Either party with the consent of the other may sue for the benefit of whom it may concern.

Source: L. 91: Entire article added, p. 318, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: Section 2-722.
Changes: Revised to reflect leasing practices and terminology.
Definitional Cross References:
"Action". Section 1-201(1).
"Goods". Section 2A-103(1)(h).
"Lease contract". Section 2A-103(1)(l).
"Lessee". Section 2A-103(1)(n).
"Lessor". Section 2A-103(1)(p).
"Party". Section 1-201(29).
"Rights". Section 1-201(36).
"Security interest". Section 1-201(37).

4-2.5-532. Lessor's rights to residual interest. In addition to any other recovery permitted by this article or other law, the lessor may recover from the lessee an amount that will fully compensate the lessor for any loss of or damage to the lessor's residual interest in the goods caused by the default of the lessee.

Source: L. 91: Entire article added, p. 318, § 1, effective July 1, 1992.

OFFICIAL COMMENT

Uniform Statutory Source: None.
Purposes: This section recognizes the right of the lessor to recover under this Article (as well as under other law) from the lessee for failure to comply with the lease obligations as to the condition of leased goods when returned to the lessor, for failure to return the goods at the end of the lease, or for any other default which causes loss or injury to the lessor's residual interest in the goods.

4-2.5-533. Other measures of damages. Notwithstanding any other provision of this article, except as otherwise provided with respect to damages liquidated in the lease agreement (section 4-2.5-504) or otherwise determined pursuant to agreement of the parties (sections 4-1-302 and 4-2.5-503), a party to a lease contract, at his or her option, may recover for the other party's default, in addition to or in lieu of the damages expressly authorized by this article, such additional or different damages as may be necessary to put such party in as good a position as if the other party had performed in accordance with the lease contract, determined in any reasonable manner.

Source: L. 91: Entire article added, p. 318, § 1, effective July 1, 1992. **L. 2006:** Entire section amended, p. 496, § 24, effective September 1.

Editor's note - Colorado legislative change. This section was added by Colorado; it has no counterpart in the uniform act.

ARTICLE 3

Negotiable Instruments

Editor's note: This article was numbered as article 3 of chapter 155, C.R.S. 1963. The provisions of this article were repealed and reenacted in 1994, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 1994, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated.

PART 1

GENERAL PROVISIONS AND DEFINITIONS

PART 2

NEGOTIATION, TRANSFER, AND INDORSEMENT

PART 3

ENFORCEMENT OF INSTRUMENTS

PART 4

LIABILITY OF PARTIES

PART 5

DISHONOR

PART 6

DISCHARGE AND PAYMENT

PREFATORY NOTE

Revised Article 3 (with miscellaneous and conforming amendments to Articles 1 and 4) is a companion undertaking to Article 4A (numbered as article 4.5 in C.R.S.) on funds transfers. Both efforts were undertaken for the purpose of accommodating modern technologies and practices in payment systems and with respect to negotiable instruments. Both efforts were drafted by the same committee over essentially the same period of time. The work on Article 4A was accorded priority and completed in 1989, and revised Article 3 was completed in 1990.

Revised Article 3 may, not inappropriately, be regarded as the latest effort in the progressive codification of the common law of negotiable instruments that began with the English Bills of Exchange Act enacted by Parliament in 1882. The Uniform Negotiable Instruments Law was promulgated by the Conference in 1896, and it in turn was reorganized and modernized by original Article 3 - Commercial Paper as part of the Uniform Commercial Code jointly promulgated in 1952 by the Conference and the American Law Institute. Revised Article 3 in 1990 modernizes, reorganizes, and clarifies the law.

Purpose of Drafting Effort

The original Articles 3 and 4 and their predecessors were based upon a paper payment system. Literally, there has been an explosion in the volume of paper to process since Articles 3 and 4 were first promulgated. In the early '50s, around 7 billion checks were processed annually. Correctly anticipating an increase in check volume as the result of a retail approach taken by bankers at that time, the American Bankers Association in 1954 placed a team on a research and development project to identify the most efficient method of processing checks mechanically. The eminently successful MICR line technology was the result. Upon its implementation, checks were processed at high rates of speed. In major part as a result of this technology, a seven-fold explosion in check volume has occurred between the '50s and 1988. In 1988, the Federal Reserve estimated check volume at 48 billion written annually. In 1987, Congress enacted the "Expedited Funds Availability Act", and the Federal Reserve Board implemented it in 1988 with Regulation CC. Regulation CC covers many aspects of the forward check collection process and all aspects of the return process.

Present Articles 3 and 4, written for a paper-based system, do not adequately address the issues of responsibility and liability as they relate to modern technologies now employed and the procedures required by the current volume of checks and by the "Expedited Funds Availability Act" and Regulation CC. While agreements among parties to particular transactions have provided some relief, such stop-gap measures are no longer adequate.

In addition, practices have developed which are not easily accommodated within existing Article 3. For example, variable rate notes were unknown when Article 3 first was promulgated; they are common today. Questions about the "cash equivalency" of cashier's checks and money orders have arisen as banks have sought to raise defenses to the payment of these instruments.

The revision of Article 3 and Article 4 to update, improve, and maintain the viability of it is necessary to accommodate these changing practices and modern technologies, the needs of a rapidly expanding national and international economy, the requirement for more rapid funds availability, and the need for more clarity and certainty. Absent such an update, further Federal preemption of state law may likely occur.

Uniformity is Essential

Traditionally, the legal structures for payments have been regulated by state law through the Uniform Commercial Code. In recent years, however, the Federal government has established regulations for credit and debit cards, and for the availability of funds in a way that regulates much of the check collection process.

With respect to wholesale funds transfers, on an average day two trillion dollars is transferred. Article 4A of the UCC promulgated in 1989 provides the governing comprehensive rules. In 1990, 12 states enacted Article 4A including California, New York, and Illinois. In 1991, Article 4A has been introduced in the legislatures of most of the other states, and it is anticipated that most, if not all, will enacted Article 4A uniformly. Within a short time, perhaps by 1992, the law of wholesale funds transfers should be uniform throughout the 50 states.

The law for payments through checks and which governs other negotiable instruments similarly should be uniform and up-to-date, either through state enactments or Federal preemption. Otherwise, checks as a viable payment system in international and national transactions will be severely hampered and the utility of other negotiable instruments impaired.

Process of Achieving Uniformity

The essence of uniform law revision is to obtain a sufficient consensus and balance among the interests of the various participants so that universal and uniform adoption by the legislatures of all 50 states may be achieved. As is the practice of the Conference, announcement of the drafting undertaking for Articles 3, 4, and 4A was widely circulated in 1985. Anyone who so requested, received notice of all meetings and was invited to attend. Upon request, names were put on a mailing list to receive copies of drafts as they progressed. In addition, the American

Bar Association Ad Hoc Committee on Payment Systems closely followed the work of the Conference and widely circulated the drafts.

The Drafting Committee had three or four meetings each year and, by August 1990, had held 20 meetings. The drafting meetings began on Friday morning and ended on Sunday at noon. All the meetings were well attended, and the average attendance was 50 or more. The discussion of the drafts was open for comment by all those who attended. In addition, the reporters received a substantial amount of comment and suggestions by written and other communications between meetings of the Drafting Committee. The work product was read line for line at the Annual Meetings of the Conference three different years. In addition, the American Law Institute circulated the drafts two or three times to its entire membership. The ALI consultative group also held a meeting to comment and make suggestions on the draft. In addition, progress reports were published annually in **The Business Lawyer** from 1985 through 1990.

The consensus, balance, and quality achieved in this lengthy deliberative process is a product not only of the fine work of the reporters and the Drafting Committee, but also the faithful and energetic participation of the advisors and participants in the drafting meetings. The advisors representing a variety of interests were:

Thomas C. Baxter, Jr., Federal Reserve Bank of New York

Roland E. Brandel, American Bar Association

Leon P. Ciferni, National Westminster Bank USA

William B. Davenport, American Bar Association, Section of Business Law, Ad Hoc Committee on Payment Systems

Carl Felsenfeld, Association of the Bar of the City of New York

Thomas J. Greco, American Bankers Association

Oliver I. Ireland, Board of Governors of Federal Reserve System

John R. H. Kimball, Federal Reserve Bank of Boston

John F. Lee, New York Clearing House Association

Norman R. Nelson, New York Clearing House Association

Ernest T. Patrikis, Federal Reserve Bank of New York

Anne B. Pope, National Corporate Cash Management Association

Paul S. Turner, Occidental Petroleum Corporation and National Corporate Cash Management Association

Stanley M. Walker, Exxon Company, U.S.A. and National Corporate Cash Management Association

Other participants who regularly attended drafting meetings were:

Henry N. Dyhouse, U.S. Central Credit Union

Robert Egan, Chemical Bank

Paul T. Even, National Gypsum Corporation

James Foorman, First Chicago Corporation

J. Kevin French, Exxon Company, U.S.A.

Richard M. Gottlieb, Manufacturers Hanover Trust Company

Douglas E. Harris, National Corporate Cash Management Association

Arthur L. Herold, National Corporate Cash Management Association

Shirley Holder, Atlantic Richfield Company

Paul E. Homrighausen, Bankers Clearing House Association

Gail M. Inaba, Morgan Guaranty Trust Company of New York

Richard P. Kessler, Jr., Credit Union National Association

James W. Kopp, Shell Oil Company

Donald R. Lawrence, Citibank, N.A.

Robert M. McAllister, Chase Manhattan Bank, N.A.

Thomas E. Montgomery, California Bankers Association

W. Robert Moore, American Bankers Association

Samuel Newman, Manufacturers Hanover Trust Company

Nena Nodge, National Corporate Cash Management Association

Robert J. Pisapia, Occidental Petroleum Corporation

Deborah S. Prutzman, Arnold & Porter

James S. Rogers, Professor of Law, Newton, Massachusetts

Robert M. Rosenblith, Manufacturers Hanover Trust Company

Jamileh Soufan, American General Corporation

Irma Villarreal, Aon Corporation

Balance Achieved

The consensus reflected in Revised Article 3 and in the conforming amendments to Articles 1 and 4 is supported by the participants from the banking community, the users, and the Federal regulators because it reflects a balance that each interest can reasonably embrace. Some of the benefits of the Revision include:

A. Benefits in the Public Interest

Certainty - Revised Articles 3 and 4 remove numerous uncertainties that exist in the current provisions and thus reduce risk to the payment system and allow appropriate planning by its users and operators.

Speed and Reliability - The Revision removes impediments to the use of automation, and better conforms to Regulation CC to expedite the availability of funds to customers and to reduce risks to banks.

Lower Costs - The Revision, by providing for modern technologies, lowers costs to banks and thus to their customers.

Reduced Litigation - By clarification of troublesome issues, and by the provisions of Section

3-404 through 3-406 which reform rules for allocation of loss from forgeries and alterations, the Revision should significantly reduce litigation.

B. Benefits to Users

"Good Faith" - The definition of good faith under Sections 3-103(a)(4) and 4-104(c) is expanded to include observance of reasonable commercial standards of fair dealing. This objective standard for good faith applies to the performance of all duties and obligations established under Articles 3 and 4.

Fiduciary Provisions - Section 3-307 protects drawers and persons owed a fiduciary responsibility by imposing stricter standards for obtaining holder in due course rights by a person dealing with the defaulting agent or fiduciary. It also spells out the circumstances under which a person receiving funds has notice of a breach of fiduciary duty, and resulting liability.

Accord and Satisfaction - Under Section 3-311 payees can avoid the unintentional accord and satisfaction by returning the funds or by giving a notice that requires checks to be sent to a particular office where such proposals can be handled. On the other hand, the drawer of a full settlement check is protected from the instrument being indorsed with protest and thus losing the money and being liable on the balance of the claim.

Cashier's Checks - Section 3-411 and related provisions considerably improve the acceptability of bank obligations like cashier's checks as cash equivalents by providing disincentives to wrongful dishonor, such as the possible recovery of consequential damages.

Indorser Liability - Section 3-415 gives more time to hold a check before the user loses indorser liability.

Reporting Forgeries - Section 4-406 increases the outside time a customer has to report forged checks or alterations to 30 days. It also requires a bank truncating checks to retain the item or the capacity to furnish legible copies for seven years.

Individual Agent and Corporate Liability - Section 3-402, as to corporate instruments signed by agents without adequate indication and representation (except as against a holder in due course), allows a representative to show the parties did not intend individual liability. It affords full protection to the agent that signs a corporate check, even though the check does not show representative status. Also, Section 3-403(b) makes it clear that a signature of an organization is considered unauthorized if more than one signature is required and it is missing.

Direct Suits - Section 3-420 allows a person whose indorsement is forged to sue the depositary bank directly, rather than each drawee of the checks involved.

C. Benefits to the Banking Community

Certainty - Section 3-104 and related provisions clarify what types of contracts are within Article 3 and how they are to be treated, thus promoting certainty of legal rules and reducing litigation costs and risks. Checks that may omit "words of negotiability" are included as fully negotiable; confusion over travelers checks is eliminated; variable rate instruments are included; and there is clarification of the impact of the FTC "Holder" Rule, clarification of the ability of parties to an instrument that is not included in Article 3 to contract for the application of its rules to their contract; and clarification of ordinary money orders as checks rather than bank obligations.

"Ordinary Care" - In Sections 3-103(a)(7) and 4-104(c), ordinary care is defined, making clear that financial institutions taking checks for processing or for payment by automated means need not manually handle each instrument if that is consistent with the institution's procedures and the procedures used do not vary unreasonably from the general usage of banks. This clarification is designed to accommodate and facilitate efficiency, thus lowering costs and lowering expedited funds availability risks. The definition of ordinary care relates to those specific instances in the Code where the standard of ordinary care is set forth.

Statute of Limitations - Sections 3-118 and 4-111 include statutory periods of limitations which will make the law uniform rather than leaving the topic to widely varying state laws.

Employee Fraud - Section 3-405 expands a per se negligence rule to the case of an indorsement forged by an employee whose duties involve handling checks. It also covers that of a faithless employee who supplies a name and then forges the indorsement, but does not require a precise match between the name of the payee and the indorsement.

Bank Definition - The definition of bank is expanded for the purposes of Articles 3 and 4 to clearly include savings and loans and credit unions so that their checks are directly governed by the Code. Section 4-104 clarifies that checks drawn on credit lines are subject to the rules for checks drawn on deposit accounts.

Truncation - Section 4-110 authorizes electronic presentment of items and related provisions remove impediments to truncation. Truncation will reduce risks from mandated funds availability and improve the check collection process. Section 4-406 allows an institution the benefit of its provisions even though it does not return the checks due to truncation. If both the customer and the institution fail to use ordinary care, a comparative negligence standard is used rather than placing the full loss on the institution.

PART 1

GENERAL PROVISIONS AND DEFINITIONS

4-3-101. Short title. This article may be cited as "Uniform Commercial Code — Negotiable Instruments".

Source: L. 94: Entire article R&RE, p. 839, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-101 as it existed prior to 1994.

ANNOTATION

Law reviews. For article, "Formal Requisites of Negotiability — The Negotiable Instruments Law Compared With the Proposed Commercial Code", see 26 Rocky Mt. L. Rev. 1 (1953). For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965). For article, "Article 3 of the Uniform Commercial Code and Colorado Negotiable Instruments Law", see 38 U. Colo. L. Rev. 22 (1965).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

The primary purpose of the adoption of this article was to remove the confusion of local laws and decisions by making the law uniform in the different states. Winton v. Sullivan, 104 Colo. 450, 91 P.2d 996 (1939) (decided under repealed CSA, C. 112, § 1 et seq., negotiable instruments law).

4-3-102. Subject matter. (a) This article applies to negotiable instruments. It does not apply to money, to payment orders governed by article 4.5 of this title, or to securities governed by article 8 of this title.

(b) If there is conflict between this article and article 4 or 9 of this title, articles 4 and 9 govern.

(c) Regulations of the board of governors of the federal reserve system and operating circulars of the federal reserve banks supersede any inconsistent provision of this article to the extent of the inconsistency.

Source: L. 94: Entire article R&RE, p. 839, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-103 as it existed prior to 1994.

OFFICIAL COMMENT

1. Former Article 3 had no provision affirmatively stating its scope. Former Section 3-103 was a limitation on scope. In revised Article 3, Section 3-102 states that Article 3 applies to "negotiable instruments," defined in Section 3-104. Section 3-104(b) also defines the term "instrument" as a synonym for "negotiable instrument." In most places Article 3 uses the shorter term "instrument." This follows the convention used in former Article 3.

2. The reference in former Section 3-103(1) to "documents of title" is omitted as superfluous because these documents contain no promise to pay money. The definition of "payment order" in Section 4A-103(a)(1)(iii) excludes drafts which are governed by Article 3. Section 3-102(a) makes clear that a payment order governed by Article 4A is not governed by Article 3. Thus, Article 3 and Article 4A are mutually exclusive.

Article 8 states in Section 8-102(1)(c) that "A writing that is a certificated security is governed by this Article and not by Article 3, even though it also meets the requirements of that Article." Section 3-102(a) conforms to this provision. With respect to some promises or orders to pay money, there may be a question whether the promise or order is an instrument under Section 3-104(a) or a certificated security under Section 8-102(1)(a). Whether a writing is covered by Article 3 or Article 8 has important consequences. Among other things, under Section 8-207, the issuer of a certificated security may treat the registered owner as the owner for all purposes until the presentment for registration of a transfer. The issuer of a negotiable instrument, on the other hand, may discharge its obligation to pay the instrument only by paying a person entitled to enforce under Section 3-301. There are also important consequences to an

indorser. An indorser of a security does not undertake the issuer's obligation or make any warranty that the issuer will honor the underlying obligation, while an indorser of a negotiable instrument becomes secondarily liable on the underlying obligation.

Ordinarily the distinction between instruments and certificated securities in non-bearer form should be relatively clear. A certificated security under Article 8 must be in registered form (Section 8-102(1)(a)(i)) so that it can be registered on the issuer's records. By contrast, registration plays no part in Article 3. The distinction between an instrument and a certificated security in bearer form may be somewhat more difficult and will generally lie in the economic functions of the two writings. Ordinarily, negotiable instruments under Article 3 will be separate and distinct instruments, while certificated securities under Article 8 will be either one of a class or series or by their terms divisible into a class or series (Section 8-102(1)(a)(iii)). Thus, a promissory note in bearer form could come under either Article 3 if it were simply an individual note, or under Article 8 if it were one of a series of notes or divisible into a series. An additional distinction is whether the instrument is of the type commonly dealt in on securities exchanges or markets or commonly recognized as a medium for investment (Section 8-102(1)(a)(ii)). Thus, a check written in bearer form (i.e., a check made payable to "cash") would not be a certificated security within Article 8 of the Uniform Commercial Code.

Occasionally, a particular writing may fit the definition of both a negotiable instrument under Article 3 and of an investment security under Article 8. In such cases, the instrument is subject exclusively to the requirements of Article 8. Section 8-102(1)(c) and Section 3-102(a).

3. Although the terms of Article 3 apply to transactions by Federal Reserve Banks, federal preemption would make ineffective any Article 3 provision that conflicts with federal law. The activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 3-102(c) states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 3 to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. **Childs v. Federal Reserve Bank of Dallas,** 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984). Section 3-102(c) treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation. Federal statutes may also preempt Article 3. For example, the Expedited Funds Availability Act, 12 U.S.C. 4001 et seq., provides that the Act and the regulations issued pursuant to the Act supersede any inconsistent provisions of the UCC. 12 U.S.C. 4007(b).

4. In **Clearfield Trust Co. v. United States,** 318 U.S. 363 (1943), the Court held that if the United States is a party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In **United States v. Kimbell Foods, Inc.,** 440 U.S. 715 (1979), the Court stated a three-pronged test to ascertain whether the federal common-law rule should follow the state rule. In most instances courts under the **Kimbell** test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In **Kimbell** the Court adopted the priorities rules of Article 9.

5. In 1989 the United Nations Commission on International Trade Law completed a Convention on International Bills of Exchange and International Promissory Notes. If the United States becomes a party to this Convention, the Convention will preempt state law with respect to international bills and notes governed by the Convention. Thus, an international bill of exchange or promissory note that meets the definition of instrument in Section 3-104 will not be governed by Article 3 if it is governed by the Convention.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Negotiable instruments law is applicable only to negotiable instruments and the rights and duties arising thereunder. Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954) (decided under repealed CSA, C. 112, § 1, negotiable instruments law).

N.I.L. did not apply to negotiable instruments made and delivered before it took effect. Hickman-Lunbeck Grocery Co. v. Hager, 75 Colo. 554, 227 P. 829 (1924) (decided under repealed laws antecedent to CSA, C. 112, § 195, negotiable instruments law).

Applied in Hollemon v. Murray, 666 P.2d 1107 (Colo. App. 1982).

4-3-103. Definitions. (a) In this article:

(1) "Acceptor" means a drawee who has accepted a draft.

(2) "Drawee" means a person ordered in a draft to make payment.

(3) "Drawer" means a person who signs or is identified in a draft as a person ordering payment.

(4) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(5) "Maker" means a person who signs or is identified in a note as a person undertaking to pay.

(6) "Order" means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay.

(7) "Ordinary care" in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged. In the case of a bank that takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage not disapproved by this article or article 4 of this title.

(8) "Party" means a party to an instrument.

(9) "Promise" means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.

(10) "Prove" with respect to a fact means to meet the burden of establishing the fact (section 4-1-201 (b) (8)).

(11) "Remitter" means a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser.

(b) Other definitions applying to this article and the sections in which they appear are:

"Acceptance"	Section 4-3-409
"Accommodated party"	Section 4-3-419
"Accommodation party"	Section 4-3-419
"Alteration"	Section 4-3-407
"Anomalous indorsement"	Section 4-3-205
"Blank indorsement"	Section 4-3-205
"Cashier's check"	Section 4-3-104
"Certificate of deposit"	Section 4-3-104
"Certified check"	Section 4-3-409
"Check"	Section 4-3-104
"Consideration"	Section 4-3-303
"Demand draft"	Section 4-3-104
"Draft"	Section 4-3-104
"Holder in due course"	Section 4-3-302
"Incomplete instrument"	Section 4-3-115
"Indorsement"	Section 4-3-204
"Indorser"	Section 4-3-204
"Instrument"	Section 4-3-104
"Issue"	Section 4-3-105
"Issuer"	Section 4-3-105
"Negotiable instrument"	Section 4-3-104
"Negotiation"	Section 4-3-201
"Note"	Section 4-3-104
"Payable at a definite time"	Section 4-3-108
"Payable on demand"	Section 4-3-108
"Payable to bearer"	Section 4-3-109

"Payable to order"	Section 4-3-109
"Payment"	Section 4-3-602
"Person entitled to enforce"	Section 4-3-301
"Presentment"	Section 4-3-501
"Reacquisition"	Section 4-3-207
"Special indorsement"	Section 4-3-205
"Teller's check"	Section 4-3-104
"Transfer of instrument"	Section 4-3-203
"Traveler's check"	Section 4-3-104
"Value"	Section 4-3-303

(c) The following definitions in other articles apply to this article:

"Bank"	Section 4-4-105
"Banking day"	Section 4-4-104
"Clearing house"	Section 4-4-104
"Collecting bank"	Section 4-4-105
"Depositary bank"	Section 4-4-105
"Documentary draft"	Section 4-4-104
"Intermediary bank"	Section 4-4-105
"Item"	Section 4-4-104
"Payor bank"	Section 4-4-105
"Suspends payments"	Section 4-4-104

(d) In addition, article 1 of this title contains general definitions and principles of construction and interpretation applicable throughout this article.

Source: L. 94: Entire article R&RE, p. 840, § 1, effective January 1, 1995. **L. 2001:** (b) amended, p. 865, § 2, effective August 8. **L. 2006:** (a)(10) amended, p. 496, § 25, effective September 1.

Editor's note: This section is similar to former § 4-3-102 as it existed prior to 1994.

Cross references: For the legislative declaration contained in the 2001 act amending subsection (b), see section 1 of chapter 244, Session Laws of Colorado 2001.

OFFICIAL COMMENT

1. Subsection (a) defines some common terms used throughout the Article that were not defined by former Article 3 and adds the definitions of "order" and "promise" found in former Section 3-102(1)(b) and (c).

2. The definition of "order" includes an instruction given by the signer to itself. The most common example of this kind of order is a cashier's check: a draft with respect to which the drawer and drawee are the same bank or branches of the same bank. Former Section 3-118(a) treated a cashier's check as a note. It stated "a draft drawn on the drawer is effective as a note." Although it is technically more correct to treat a cashier's check as a promise by the issuing bank to pay rather than an order to pay, a cashier's check is in the form of a check and it is normally referred to as a check. Thus, revised Article 3 follows banking practice in referring to a cashier's check as both a draft and a check rather than a note. Some insurance companies also follow the practice of issuing drafts in which the drawer draws on itself and makes the draft payable at or through a bank. These instruments are also treated as drafts. The obligation of the drawer of a cashier's check or other draft drawn on the drawer is stated in Section 3-412.

An order may be addressed to more than one person as drawee either jointly or in the alternative. The authorization of alternative drawees follows former Section 3-102(1)(b) and recognizes the practice of drawers, such as corporations issuing dividend checks, who for commercial convenience name a number of drawees, usually in different parts of the country. Section 3-501(b)(1) provides that presentment may be made to any one of multiple drawees. Drawees in succession are not permitted because the holder should not be required to make more than one presentment. Dishonor by any drawee named in the draft entitles the holder to rights of recourse against the drawer or indorsers.

3. The last sentence of subsection (a)(9) is intended to make it clear that an I.O.U. or other written acknowledgement of indebtedness is not a note unless there is also an undertaking to pay the obligation.

4. Subsection (a)(4) introduces a definition of good faith to apply to Articles 3 and 4. Former Articles 3 and 4 used the definition in

Section 1-201(19). The definition in subsection (a)(4) is consistent with the definitions of good faith applicable to Articles 2, 2A, 4, and 4A. The definition requires not only honesty in fact but also "observance of reasonable commercial standards of fair dealing." Although fair dealing is a broad term that must be defined in context, it is clear that it is concerned with the fairness of conduct rather than the care with which an act is performed. Failure to exercise ordinary care in conducting a transaction is an entirely different concept than failure to deal fairly in conducting the transaction. Both fair dealing and ordinary care, which is defined in Section 3-103(a)(7), are to be judged in the light of reasonable commercial standards, but those standards in each case are directed to different aspects of commercial conduct.

5. Subsection (a)(7) is a definition of ordinary care which is applicable not only to Article 3 but to Article 4 as well. See Section 4-104(c). The general rule is stated in the first sentence of subsection (a)(7) and it applies both to banks and to persons engaged in businesses other than banking. Ordinary care means observance of reasonable commercial standards of the relevant business prevailing in the area in which the person is located. The second sentence of subsection (a)(7) is a particular rule limited to the duty of a bank to examine an instrument taken by a bank for processing for collection or payment by automated means. This particular rule applies primarily to Section 4-406 and it is discussed in Comment 4 to that section. Nothing in Section 3-103(a)(7) is intended to prevent a customer from proving that the procedures followed by a bank are unreasonable, arbitrary, or unfair.

6. In subsection (c) reference is made to a new definition of "bank" in amended Article 4.

ANNOTATION

Annotator's note. Since § 4-3-103 is similar to § 4-3-102 and 4-3-118 as they existed prior to the repeal and reenactment of this article, effective January 1, 1995, see the annotations under former § 4-3-102 and § 4-3-118 in the 1992 replacement volume.

Negotiable instruments law is applicable only to negotiable instruments and the rights and duties arising thereunder. Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954) (decided under repealed CSA, C. 112, § 1, negotiable instruments law).

N.I.L. did not apply to negotiable instruments made and delivered before it took effect. Hickman-Lunbeck Grocery Co. v. Hager, 75 Colo. 554, 227 P. 829 (1924) (decided under repealed laws antecedent to CSA, C. 112, § 195, negotiable instruments law).

Bad faith. For purposes of subsection (5), bad faith means actions in knowing or reckless disregard of customer's contractual rights and negligence alone does not constitute bad faith. Peregrine Homes v. Jefferson Bank & Trust, 713 P.2d 1342 (Colo. App. 1985).

Applied in Hollemon v. Murray, 666 P.2d 1107 (Colo. App. 1982).

4-3-104. Negotiable instrument. (a) Except as provided in subsections (c) and (d) of this section, "negotiable instrument" means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

(1) Is payable to bearer or to order at the time it is issued or first comes into possession of a holder;

(2) Is payable on demand or at a definite time; and

(3) Does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

(b) "Instrument" means a negotiable instrument.

(c) An order that meets all of the requirements of subsection (a) of this section, except paragraph (1), and otherwise falls within the definition of "check" in subsection (f) of this section is a negotiable instrument and a check.

(d) A promise or order other than a check is not an instrument if, at the time it is issued or first comes into possession of a holder, it contains a conspicuous statement, however expressed, to the effect that the promise or order is not negotiable or is not an instrument governed by this article.

(e) An instrument is a "note" if it is a promise and is a "draft" if it is an order. If an

instrument falls within the definition of both "note" and "draft," a person entitled to enforce the instrument may treat it as either.

(f) "Check" means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank, (ii) a cashier's check or teller's check, or (iii) a demand draft. An instrument may be a check even though it is described on its face by another term, such as "money order."

(g) "Cashier's check" means a draft with respect to which the drawer and drawee are the same bank or branches of the same bank.

(h) "Teller's check" means a draft drawn by a bank (i) on another bank, or (ii) payable at or through a bank.

(i) "Traveler's check" means an instrument that (i) is payable on demand, (ii) is drawn on or payable at or through a bank, (iii) is designated by the term "traveler's check" or by a substantially similar term, and (iv) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument.

(j) "Certificate of deposit" means an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money. A certificate of deposit is a note of the bank.

(k) (i) "Demand draft" means a writing not signed by the customer that is created by a third party under the purported authority of the customer for the purpose of charging the customer's account with a bank. A demand draft shall contain the customer's account number and shall contain any or all of the following:

(1) The customer's printed or typewritten name;

(2) A notation that the customer authorized the draft; or

(3) The statement "No signature required" or words to that effect.

(ii) A demand draft shall not include a check purportedly drawn by and bearing the signature of a fiduciary, as defined in section 4-3-307 (a) (1).

Source: L. 94: Entire article R&RE, p. 843, § 1, effective January 1, 1995. **L. 2001:** (f) amended and (k) added, p. 866, § 3, effective August 8.

Editor's note: This section is similar to former § 4-3-104 as it existed prior to 1994.

Cross references: (1) For other agreements affecting instrument, see § 4-3-117.

(2) For the legislative declaration contained in the 2001 act amending subsection (f) and enacting subsection (k), see section 1 of chapter 244, Session Laws of Colorado 2001.

OFFICIAL COMMENT

1. The definition of "negotiable instrument" defines the scope of Article 3 since Section 3-102 states: "This Article applies to negotiable instruments." The definition in Section 3-104(a) incorporates other definitions in Article 3. An instrument is either a "promise," defined in Section 3-103(a)(9), or "order," defined in Section 3-103(a)(6). A promise is a written undertaking to pay money signed by the person undertaking to pay. An order is a written instruction to pay money signed by the person giving the instruction. Thus, the term "negotiable instrument" is limited to a signed writing that orders or promises payment of money. "Money" is defined in Section 1-201(24) and is not limited to United States dollars. It also includes a medium of exchange established by a foreign government or monetary units of account established by an intergovernmental organization or by agreement between two or more nations. Five other requirements are stated in Section 3-104(a): First, the promise or order must be "unconditional." The quoted term is explained in Section 3-106. Second, the amount of money must be "a fixed amount * * * with or without interest or other charges described in the promise or order." Section 3-112(b) relates to "interest." Third, the promise or order must be "payable to bearer or to order." The quoted phrase is explained in Section 3-109. An exception to this requirement is stated in subsection (c). Fourth, the promise or order must be payable "on demand or at a definite time." The quoted phrase is explained in Section 3-108. Fifth, the promise or order may not state "any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money" with three exceptions. The quoted phrase is based on the first sentence of N.I.L. Section 5 which is the precursor of "no other promise, order, obligation or power given by the maker or drawer" appearing in former Section 3-104(1)(b). The words "instruction" and "undertaking" are used

instead of "order" and "promise" that are used in the N.I.L. formulation because the latter words are defined terms that include only orders or promises to pay money. The three exceptions stated in Section 3-104(a)(3) are based on and are intended to have the same meaning as former Section 3-112(1)(b), (c), (d), and (e), as well as N.I.L. § 5(1), (2), and (3). Subsection (b) states that "instrument" means a "negotiable instrument." This follows former Section 3-102(1)(e) which treated the two terms as synonymous.

2. Unless subsection (c) applies, the effect of subsection (a)(1) and Section 3-102(a) is to exclude from Article 3 any promise or order that is not payable to bearer or to order. There is no provision in revised Article 3 that is comparable to former Section 3-805. The Comment to former Section 3-805 states that the typical example of a writing covered by that section is a check reading "Pay John Doe." Such a check was governed by former Article 3 but there could not be a holder in due course of the check. Under Section 3-104(c) such a check is governed by revised Article 3 and there can be a holder in due course of the check. But subsection (c) applies only to checks. The Comment to former Section 3-805 does not state any example other than the check to illustrate that section. Subsection (c) is based on the belief that it is good policy to treat checks, which are payment instruments, as negotiable instruments whether or not they contain the words "to the order of". These words are almost always pre-printed on the check form. Occasionally the drawer of a check may strike out these words before issuing the check. In the past some credit unions used check forms that did not contain the quoted words. Such check forms may still be in use but they are no longer common. Absence of the quoted words can easily be overlooked and should not affect the rights of holders who may pay money or give credit for a check without being aware that it is not in the conventional form.

Total exclusion from Article 3 of other promises or orders that are not payable to bearer or to order serves a useful purpose. It provides a simple device to clearly exclude a writing that does not fit the pattern of typical negotiable instruments and which is not intended to be a negotiable instrument. If a writing could be an instrument despite the absence of "to order" or "to bearer" language and a dispute arises with respect to the writing, it might be argued that the writing is a negotiable instrument because the other requirements of subsection (a) are somehow met. Even if the argument is eventually found to be without merit it can be used as a litigation ploy. Words making a promise or order payable to bearer or to order are the most distinguishing feature of a negotiable instrument and such words are frequently referred to as "words of negotiability." Article 3 is not meant to apply to contracts for the sale of goods or services or the sale or lease of real property or similar writings that may contain a promise to pay money. The use of words of negotiability in such contracts would be an aberration. Absence of the words precludes any argument that such contracts might be negotiable instruments.

An order or promise that is excluded from Article 3 because of the requirements of Section 3-104(a) may nevertheless be similar to a negotiable instrument in many respects. Although such a writing cannot be made a negotiable instrument within Article 3 by contract or conduct of its parties, nothing in Section 3-104 or in Section 3-102 is intended to mean that in a particular case involving such a writing a court could not arrive at a result similar to the result that would follow if the writing were a negotiable instrument. For example, a court might find that the obligor with respect to a promise that does not fall within Section 3-104(a) is precluded from asserting a defense against a bona fide purchaser. The preclusion could be based on estoppel or ordinary principles of contract. It does not depend upon the law of negotiable instruments. An example is stated in the paragraph following Case #2 in Comment 4 to Section 3-302.

Moreover, consistent with the principle stated in Section 1-102(2)(b), the immediate parties to an order or promise that is not an instrument may provide by agreement that one or more of the provisions of Article 3 determine their rights and obligations under the writing. Upholding the parties' choice is not inconsistent with Article 3. Such an agreement may bind a transferee of the writing if the transferee has notice of it or the agreement arises from usage of trade and the agreement does not violate other law or public policy. An example of such an agreement is a provision that a transferee of the writing has the rights of a holder in due course stated in Article 3 if the transferee took rights under the writing in good faith, for value, and without notice of a claim or defense.

Even without an agreement of the parties to an order or promise that is not an instrument, it may be appropriate, consistent with the principles stated in Section 1-102(2), for a court to apply one or more provisions of Article 3 to the writing by analogy, taking into account the expectations of the parties and the differences between the writing and an instrument governed by Article 3. Whether such application is appropriate depends upon the facts of each case.

3. Subsection (d) allows exclusion from Article 3 of a writing that would otherwise be an instrument under subsection (a) by a statement to the effect that the writing is not negotiable or is not governed by Article 3. For example, a promissory note can be stamped with the legend NOT NEGOTIABLE. The effect under subsec-

tion (d) is not only to negate the possibility of a holder in due course, but to prevent the writing from being a negotiable instrument for any purpose. Subsection (d) does not, however, apply to a check. If a writing is excluded from Article 3 by subsection (d), a court could, nevertheless, apply Article 3 principles to it by analogy as stated in Comment 2.

4. Instruments are divided into two general categories: drafts and notes. A draft is an instrument that is an order. A note is an instrument that is a promise. Section 3-104(e). The term "bill of exchange" is not used in Article 3. It is generally understood to be a synonym for the term "draft." Subsections (f) through (j) define particular instruments that fall within the categories of draft and note. The term "draft," defined in subsection (e), includes a "check" which is defined in subsection (f). "Check" includes a share draft drawn on a credit union payable through a bank because the definition of bank (Section 4-105) includes credit unions. However, a draft drawn on an insurance company payable through a bank is not a check because it is not drawn on a bank. "Money orders" are sold both by banks and non-banks. They vary in form and their form determines how they are treated in Article 3. The most common form of money order sold by banks is that of an ordinary check drawn by the purchaser except that the amount is machine impressed. That kind of money order is a check under Article 3 and is subject to a stop order by the purchaser-drawer as in the case of ordinary checks. The seller bank is the drawee and has no obligation to a holder to pay the money order. If a money order falls within the definition of a teller's check, the rules applicable to teller's checks apply. Postal money orders are subject to federal law. "Teller's check" is separately defined in subsection (h). A teller's check is always drawn by a bank and is usually drawn on another bank. In some cases a teller's check is drawn on a nonbank but is made payable at or through a bank. Article 3 treats both types of teller's check identically, and both are included in the definition of "check." A cashier's check, defined in subsection (g), is also included in the definition of "check." Traveler's checks are issued both by banks and non-banks and may be in the form of a note or draft. Subsection (i) states the essential characteristics of a traveler's check. The requirement that the instrument be "drawn on or payable at or through a bank" may be satisfied without words on the instrument that identify a bank as drawee or paying agent so long as the instrument bears an appropriate routing number that identifies a bank as paying agent.

The definitions in Regulation CC § 229.2 of the terms "check," "cashier's check," "teller's check," and "traveler's check" are different from the definitions of those terms in Article 3.

Certificates of deposit are treated in former Article 3 as a separate type of instrument. In revised Article 3, Section 3-104(j) treats them as notes.

ANNOTATION

I. GENERAL CONSIDERATION.

Law reviews. For comment on Steward v. Pub. Indus. Bank appearing below, see 2 Rocky Mt. L. Rev. 200 (1930). For article, "Setoff and Security Interests In Deposit Accounts", see 17 Colo. Law. 2107 (1988).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Conditional language in promissory note referencing conditions in the bill of sale and covenants not to compete renders it nonnegotiable but does not make the note unenforceable. DBA Enter., Inc. v. Findlay, 923 P.2d 298 (Colo. App. 1996).

A note authorizing confession of judgment in the event of nonpayment does not render the note nonnegotiable. Axelson v. Dailey Coop. Co., 88 Colo. 555, 298 P. 957 (1931).

The authority to confess judgment is construed strictly against the party in whose favor it is given. Stewart v. Pub. Indus. Bank, 85 Colo. 546, 277 P. 782 (1929).

"Owing" construed as "due". Where a note was made payable on or before 12 months after date, to be paid in monthly installments, a provision permitting a judgment for amounts then "owing", was construed to permit a judgment for amounts then "due". Stewart v. Pub. Indus. Bank, 85 Colo. 546, 277 P. 782 (1929).

Note payable in installments is negotiable. A promissory note made payable on or before 12 months after date to be paid in monthly installments is negotiable, inasmuch as principal of note payable one year from date is "owing" when note is given but is not then "due". Stewart v. Pub. Indus. Bank, 85 Colo. 546, 277 P. 782 (1929).

Where the holder of a note payable in installments agrees to postpone subsequent installments upon the payment of pending interim installments, thereby extending the time of the installments, there is an accord and satisfaction without regard to the question of consideration for an extension where the debtor fulfills the requirements. French v. Commercial Credit Co., 99 Colo. 447, 64 P.2d 127 (1936).

Principal not altered as basis of interest. Provision in note that upon a contingency a portion of the note should be cancelled does not alter the principal amount of the note as the basis of interest computation. Colo. Herald Publishing Co. v. Neuhaus, 117 Colo. 172, 184 P.2d 1011 (1947).

Renewal notes given by administratrix held not to change character of original indebtedness. Haley v. Austin, 74 Colo. 571, 223 P. 43 (1924).

Applied in State ex rel. State Banking Bd. v. First Nat'l Bank, 394 F. Supp. 979 (D. Colo. 1975); West Greeley Nat'l Bank v. Wygant, 650 P.2d 1339 (Colo. App. 1982).

II. NEGOTIABLE INSTRUMENT - REQUIREMENTS.

Construction of promissory note should be adopted which is favorable to validity of instrument. Metro. State Bank v. McNutt, 73 Colo. 291, 215 P. 151 (1923).

For a promissory note to be negotiable, and to pass to an indorsee thereof the protections afforded to a "holder in due course", it must contain both an unconditional promise to pay and a fixed or determinable date of payment. Bank of Kimball v. Rostek, 161 Colo. 584, 423 P.2d 579 (1967).

To be a negotiable instrument subject to the statutes governing such instruments, an instrument must contain an unconditional promise to pay a fixed amount of money on demand or at a definite time. If a written agreement makes an obligation to pay subject to an express condition, not payable on demand, the agreement is not a negotiable instrument, and the statutory provisions relating to negotiable instruments are inapplicable to the transaction. Reid v. Pyle, 51 P.3d 1064 (Colo. App. 2002).

Where plaintiff's obligation to pay was expressly conditioned on "the sale or transference" of the property, the promissory note was not a negotiable instrument. Reid v. Pyle, 51 P.3d 1064 (Colo. App. 2002).

A note conditioned on its face on services to be rendered and which is not to be paid until the object of the services is secured is nonnegotiable. Mulligan v. Smith, 13 Colo. App. 231, 57 P. 731 (1899).

Recitation that note is secured does not render a note nonnegotiable. A promissory note containing an unconditional promise to pay a definite amount on demand is not rendered nonnegotiable because it recites that it is secured by a quitclaim deed. First Nat'l Bank v. Mineral Farm Co., 17 Colo. App. 452, 68 P. 981 (1902).

Provisions for foreclosure. Where a negotiable note is secured by a deed of trust, provisions in the deed providing for foreclosure upon the grantor's failure to pay taxes and insurance do not render the note uncertain as to amount or time of payment. Frost v. Fisher, 13 Colo. App. 322, 58 P. 872 (1899).

Uncertainty as to time of payment of a note does not affect it as an enforceable contract between the parties thereto, although it makes it nonnegotiable. Simpson v. Baber, 74 Colo. 175, 220 P. 235 (1923).

The fact that a note does not contain the words "to order" or "to bearer" does not affect its negotiability. Patent Title Co. v. Stratton, 89 F. 174 (D. Colo. 1898).

III. NEGOTIABLE INSTRUMENT - TYPES.

A check is a species of bill of exchange, viz., that particular kind of a bill which is drawn on a bank and payable on demand. Van Buskirk v. State Bank, 35 Colo. 142, 83 P. 778 (1905).

A check is considered a thing of value. Updike v. People, 92 Colo. 125, 18 P.2d 472 (1933).

Where one issues a check there is an implied representation that there are sufficient funds in bank at the time to cover the check. Kilbourn v. Western Surety Co., 187 F.2d 567 (10th Cir. 1951).

A bank certificate of deposit is a negotiable instrument and subject to transfer. LeZotte v. Bank of Del Norte, 86 Colo. 136, 278 P. 606 (1929).

Instrument acknowledging existing debt is not promissory note. Shearer v. Shearer, 84 Colo. 234, 269 P. 19 (1928).

For purposes of a cashier's check, since the issuing bank is both the drawer and the drawee, the check becomes a promise by the bank to draw the amount of the check from its own resources and to pay the check upon demand. Flatiron Linen, Inc. v. First Amer. State Bank, 23 P.3d 1209 (Colo. 2001).

Thus, the issuance of a cashier's check constitutes an acceptance by the issuing bank and the cashier's check itself becomes the primary obligation of the bank. Flatiron Linen, Inc. v. First Amer. State Bank, 23 P.3d 1209 (Colo. 2001).

Once the bank issues and delivers the cashier's check to the payee, the transaction is complete as far as the payee is concerned. Flatiron Linen, Inc. v. First Amer. State Bank, 23 P.3d 1209 (Colo. 2001).

Because the issuing bank is obligated to pay the cashier's check upon presentment, a cashier's check is essentially the same as cash. Flatiron Linen, Inc. v. First Amer. State Bank, 23 P.3d 1209 (Colo. 2001).

Cashier's checks represent the unconditional obligation of the issuing bank to pay, and therefore, banks may not dishonor their cashier's checks once issued. Flatiron Linen, Inc. v. First Amer. State Bank, 23 P.3d 1209 (Colo. 2001).

IV. ATTORNEY FEES.

A negotiable instrument is not rendered nonnegotiable by provisions for attorney fees if not paid at maturity. Cowing v. Cloud, 16 Colo. App. 326, 65 P. 417 (1901).

A stipulation for attorney's fees is intended to protect the holder against loss, if the maker fails to fulfill his undertaking, and there is no reason why the latter may not contract to bear the result occasioned by his own default. Florence Oil Ref. Co. v. Hiawatha Gas, Oil, & Ref. Co., 55 Colo. 378, 135 P. 454 (1913).

Indemnification for collection expenses. A provision for a fixed amount for attorney fees is an agreement to indemnify the holder against expenses incurred in the employing of an attorney for the enforcement of collection when the maker fails to keep his agreement. Florence Oil Ref. Co. v. Hiawatha Gas, Oil, & Ref. Co., 55 Colo. 378, 135 P. 454 (1913).

The holder can only recover such part thereof as will reimburse him for the reasonable and necessary attorney fees he has been compelled to pay, or has become liable for, in enforcing the collection of the note. Florence Oil Ref. Co. v. Hiawatha Gas, Oil, & Ref. Co., 55 Colo. 378, 135 P. 454 (1913).

Reasonableness of attorney fees is implicit in such an agreement. Where under the terms of a note, the holder is authorized to collect attorney fees for collection costs in case of default, implicit in such agreement is the recognition that such attorney fees will be reasonable, that is, commensurate with the actual labor and time expended by the attorney. Haffke v. Linker, 30 Colo. App. 61, 489 P.2d 1050 (1971).

Expenses incurred must be actual and bona fide expenses. Where a note provides for an attorney fee, and the holder of the note employs counsel, who successfully brings suit on the note, a reasonable fee fixed by the court may be included in the judgment. Such a provision amounts to an agreement to indemnify the holder of the note against expenses actually incurred, and the payment or obligation must be actual, bona fide, and reasonable. Luby v. Jefferson County Bank, 28 Colo. App. 441, 476 P.2d 292 (1970).

Attorney fees must be shown to have been incurred and reasonable. The holder of a note providing for the payment of reasonable attorney fees upon collection is entitled to the recovery of such a fee only upon a showing that the fee actually has been paid or incurred, and that the amount of the fee is reasonable. Haffke v. Linker, 30 Colo. App. 76, 489 P.2d 1047 (1971).

Necessity to prove that fees were actually incurred. Proof that attorney fees provided for by a promissory note have actually been paid or incurred is a material matter to be proven, because recompense is justified only as indemnity to the note holder; absent proof of payment or obligation, there is nothing to indemnify, and hence there can be no recovery. Reese v. Lietzan, 160 Colo. 253, 419 P.2d 959 (1966).

Fact of agreement does not establish reasonableness. Merely because there is an agreement as to a contingent fee between the holder and an attorney does not mean that the sum agreed upon is a reasonable fee to be assessed against the maker in an action to collect the balance due on default. Haffke v. Linker, 30 Colo. App. 61, 489 P.2d 1050 (1971).

Testimony of usual fee does not establish reasonableness. Testimony relating only to the usual fee arrangement between the holder of a note and an attorney employed by the holder to collect the note does not establish the reasonableness of an attorney fee which a holder is entitled to recover from the maker in a suit on a promissory note. Haffke v. Linker, 30 Colo. App. 76, 489 P.2d 1047 (1971).

4-3-105. Issue of instrument. (a) "Issue" means the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person.

(b) An unissued instrument, or an unissued incomplete instrument that is completed, is binding on the maker or drawer, but nonissuance is a defense. An instrument that is conditionally issued or is issued for a special purpose is binding on the maker or drawer, but failure of the condition or special purpose to be fulfilled is a defense.

(c) "Issuer" applies to issued and unissued instruments and means a maker or drawer of an instrument.

Source: L. 94: Entire article R&RE, p. 844, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-102 as it existed prior to 1994.

OFFICIAL COMMENT

1. Under former Section 3-102(1)(a) "issue" was defined as the first delivery to a "holder or a remitter" but the term "remitter" was neither defined nor otherwise used. In re-

vised Article 3, Section 3-105(a) defines "issue" more broadly to include the first delivery to anyone by the drawer or maker for the purpose of giving rights to anyone on the instrument. "Delivery" with respect to instruments is defined in Section 1-201(14) as meaning "voluntary transfer of possession."

2. Subsection (b) continues the rule that nonissuance, conditional issuance or issuance for a special purpose is a defense of the maker or drawer of an instrument. Thus, the defense can be asserted against a person other than a holder in due course. The same rule applies to nonissuance of an incomplete instrument later completed.

3. Subsection (c) defines "issuer" to include the signer of an unissued instrument for convenience of reference in the statute.

ANNOTATION

Annotator's note. Since § 4-3-105 is similar to §§ 4-3-102 and 4-3-306 as they existed prior to the repeal and reenactment of this article, effective January 1, 1995, see the annotations under former §§ 4-3-102 and 4-3-106 in the 1992 replacement volume.

If a note is conditional no recovery can be had unless the condition has been performed or the performance waived. Abercrombie v. Bear Canon Coal Co., 86 Colo. 169, 279 P. 42 (1929); Bank of Kimball v. Rostek, 161 Colo. 584, 423 P.2d 579 (1967).

Evidence may be introduced to show that there was a conditional delivery of a check that has not been fulfilled where payee brings an action against the drawer, as such does not vary the terms of the written instrument, but shows want of an element essential to its character — unconditional delivery. Norman v. McCarthy, 56 Colo. 290, 138 P. 28 (1914).

Maker may show that note was never made or delivered unconditionally with the intention that it should be binding in all events according to its terms. Burenheide v. Wall, 131 Colo. 371, 281 P.2d 1000 (1955).

A parol agreement made contemporary with the execution of a note that it is to be paid only from the maker's share of dividends of a corporate payee is a valid defense in an action on the note by an assignee after maturity. George v. Williams, 27 Colo. App. 400, 149 P. 837 (1915).

Applied in West Greeley Nat'l Bank v. Wygant, 650 P.2d 1339 (Colo. App. 1982).

4-3-106. Unconditional promise or order. (a) Except as provided in this section, for the purposes of section 4-3-104 (a), a promise or order is unconditional unless it states (i) an express condition to payment, (ii) that the promise or order is subject to or governed by another writing, or (iii) that rights or obligations with respect to the promise or order are stated in another writing. A reference to another writing does not of itself make the promise or order conditional.

(b) A promise or order is not made conditional (i) by a reference to another writing for a statement of rights with respect to collateral, prepayment, or acceleration, or (ii) because payment is limited to resort to a particular fund or source.

(c) If a promise or order requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the promise or order, the condition does not make the promise or order conditional for the purposes of section 4-3-104 (a). If the person whose specimen signature appears on an instrument fails to countersign the instrument, the failure to countersign is a defense to the obligation of the issuer, but the failure does not prevent a transferee of the instrument from becoming a holder of the instrument.

(d) If a promise or order at the time it is issued or first comes into possession of a holder contains a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the issuer could assert against the original payee, the promise or order is not thereby made conditional for the purposes of section 4-3-104 (a); but if the promise or order is an instrument, there cannot be a holder in due course of the instrument.

Source: L. 94: Entire article R&RE, p. 844, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-105 as it existed prior to 1994.

OFFICIAL COMMENT

1. This provision replaces former Section 3-105. Its purpose is to define when a promise or order fulfills the requirement in Section 3-104(a) that it be an "unconditional" promise or order to pay. Under Section 3-106(a) a promise or order is deemed to be unconditional unless one of the two tests of the subsection make the promise or order conditional. If the promise or order states an express condition to payment, the promise or order is not an instrument. For example, a promise states, "I promise to pay $100,000 to the order of John Doe if he conveys title to Blackacre to me." The promise is not an instrument because there is an express condition to payment. However, suppose a promise states, "In consideration of John Doe's promise to convey title to Blackacre I promise to pay $100,000 to the order of John Doe." That promise can be an instrument if Section 3-104 is otherwise satisfied. Although the recital of the executory promise of Doe to convey Blackacre might be read as an implied condition that the promise be performed, the condition is not an express condition as required by Section 3-106(a)(i). This result is consistent with former Section 3-105(1)(a) and (b). Former Section 3-105(1)(b) is not repeated in Section 3-106 because it is not necessary. It is an example of an implied condition. Former Section 3-105(1)(d), (e), and (f) and the first clause of former Section 3-105(1)(c) are other examples of implied conditions. They are not repeated in Section 3-106 because they are not necessary. The law is not changed.

Section 3-106(a)(ii) and (iii) carry forward the substance of former Section 3-105(2)(a). The only change is the use of "writing" instead of "agreement" and a broadening of the language that can result in conditionality. For example, a promissory note is not an instrument defined by Section 3-104 if it contains any of the following statements: 1. "This note is subject to a contract of sale dated April 1, 1990 between the payee and maker of this note." 2. "This note is subject to a loan and security agreement dated April 1, 1990 between the payee and maker of this note." 3. "Rights and obligations of the parties with respect to this note are stated in an agreement dated April 1, 1990 between the payee and maker of this note." It is not relevant whether any condition to payment is or is not stated in the writing to which reference is made. The rationale is that the holder of a negotiable instrument should not be required to examine another document to determine rights with respect to payment. But subsection (b)(i) permits reference to a separate writing for information with respect to collateral, prepayment, or acceleration.

Many notes issued in commercial transactions are secured by collateral, are subject to acceleration in the event of default, or are subject to prepayment. A statement of rights and obligations concerning collateral, prepayment, or acceleration does not prevent the note from being an instrument if the statement is in the note itself. See Section 3-104(a)(3) and Section 3-108(b). In some cases it may be convenient not to include a statement concerning collateral, prepayment, or acceleration in the note, but rather to refer to an accompanying loan agreement, security agreement or mortgage for that statement. Subsection (b)(i) allows a reference to the appropriate writing for a statement of these rights. For example, a note would not be made conditional by the following statement: "This note is secured by a security interest in collateral described in a security agreement dated April 1, 1990 between the payee and maker of this note. Rights and obligations with respect to the collateral are [stated in] [governed by] the security agreement." The bracketed words are alternatives, either of which complies.

Subsection (b)(ii) addresses the issues covered by former Section 3-105(1)(f), (g), and (h) and Section 3-105(2)(b). Under Section 3-106(a) a promise or order is not made conditional because payment is limited to payment from a particular source or fund. This reverses the result of former Section 3-105(2)(b). There is no cogent reason why the general credit of a legal entity must be pledged to have a negotiable instrument. Market forces determine the marketability of instruments of this kind. If potential buyers don't want promises or orders that are payable only from a particular source or fund, they won't take them, but Article 3 should apply.

2. Subsection (c) applies to traveler's checks or other instruments that may require a countersignature. Although the requirement of a countersignature is a condition to the obligation to pay, traveler's checks are treated in the commercial world as money substitutes and therefore should be governed by Article 3. The first sentence of subsection (c) allows a traveler's check to meet the definition of instrument by stating that the countersignature condition does not make it conditional for the purposes of Section 3-104. The second sentence states the effect of a failure to meet the condition. Suppose a thief steals a traveler's check and cashes it by skillfully imitating the specimen signature so that the countersignature appears to be authentic. The countersignature is for the purpose of identification of the owner of the instrument. It is not an indorsement. Subsection (c) provides that the failure of the owner to countersign does not prevent a transferee from becoming a holder. Thus, the merchant or bank that cashed the traveler's check becomes a holder when the traveler's check is taken. The forged countersignature is a defense to the obligation of the issuer

to pay the instrument, and is included in defenses under Section 3-305(a)(2). These defenses may not be asserted against a holder in due course. Whether a holder has notice of the defense is a factual question. If the countersignature is a very bad forgery, there may be notice. But if the merchant or bank cashed a traveler's check and the countersignature appeared to be similar to the specimen signature, there might not be notice that the countersignature was forged. Thus, the merchant or bank could be a holder in due course.

3. Subsection (d) concerns the effect of a statement to the effect that the rights of a holder or transferee are subject to claims and defenses that the issuer could assert against the original payee. The subsection applies only if the statement is required by statutory or administrative law. The prime example is the Federal Trade Commission Rule (16 C.F.R. Part 433) preserving consumers' claims and defenses in consumer credit sales. The intent of the FTC rule is to make it impossible for there to be a holder in due course of a note bearing the FTC legend and undoubtedly that is the result. But, under former Article 3, the legend may also have had the unintended effect of making the note conditional, thus excluding the note from former Article 3 altogether. Subsection (d) is designed to make it possible to preclude the possibility of a holder in due course without excluding the instrument from Article 3. Most of the provisions of Article 3 are not affected by the holder-in-due-course doctrine and there is no reason why Article 3 should not apply to a note bearing the FTC legend if holder-in-due-course rights are not involved. Under subsection (d) the statement does not make the note conditional. If the note otherwise meets the requirements of Section 3-104(a) it is a negotiable instrument for all purposes except that there cannot be a holder in due course of the note. No particular form of legend or statement is required by subsection (d). The form of a particular legend or statement may be determined by the other statute or administrative law. For example, the FTC legend required in a note taken by the seller in a consumer sale of goods or services is tailored to that particular transaction and therefore uses language that is somewhat different from that stated in subsection (d), but the difference in expression does not affect the essential similarity of the message conveyed. The effect of the FTC legend is to make the rights of a holder or transferee subject to claims or defenses that the issuer could assert against the original payee of the note.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

If a note is conditional no recovery can be had unless the condition has been performed or the performance waived. Abercrombie v. Bear Canon Coal Co., 86 Colo. 169, 279 P. 42 (1929); Bank of Kimball v. Rostek, 161 Colo. 584, 423 P.2d 579 (1967).

Statement in a promissory note providing that the maker's obligation under the note was subject to the conditions of the bill of sale and covenants not to compete rendered the note nonnegotiable but not unenforceable. DBA Enter., Inc. v. Findlay, 923 P.2d 298 (Colo. App. 1996).

Evidence may be introduced to show that there was a conditional delivery of a check that has not been fulfilled where payee brings an action against the drawer, as such does not vary the terms of the written instrument, but shows want of an element essential to its character — unconditional delivery. Norman v. McCarthy, 56 Colo. 290, 138 P. 28 (1914).

Maker may show that note was never made or delivered unconditionally with the intention that it should be binding in all events according to its terms. Burenheide v. Wall, 131 Colo. 371, 281 P.2d 1000 (1955).

A parol agreement made contemporary with the execution of a note that it is to be paid only from the maker's share of dividends of a corporate payee is a valid defense in an action on the note by an assignee after maturity. George v. Williams, 27 Colo. App. 400, 149 P. 837 (1915).

Applied in West Greeley Nat'l Bank v. Wygant, 650 P.2d 1339 (Colo. App. 1982).

4-3-107. Instrument payable in foreign money. Unless the instrument otherwise provides, an instrument that states the amount payable in foreign money may be paid in the foreign money or in an equivalent amount in dollars calculated by using the current bank-offered spot rate at the place of payment for the purchase of dollars on the day on which the instrument is paid.

Source: L. 94: Entire article R&RE, p. 844, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-107 as it existed prior to 1994.

OFFICIAL COMMENT

The definition of instrument in Section 3-104 requires that the promise or order be payable in "money." That term is defined in Section 1-201(24) and is not limited to United States dollars. Section 3-107 states than an instrument payable in foreign money may be paid in dollars if the instrument does not prohibit it. It also states a conversion rate which applies in the absence of a different conversion rate stated in the instrument. The reference in former Section 3-107(1) to instruments payable in "currency" or "current funds" has been dropped as superfluous.

4-3-108. Payable on demand or at definite time. (a) A promise or order is "payable on demand" if it (i) states that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder, or (ii) does not state any time of payment.

(b) A promise or order is "payable at a definite time" if it is payable on elapse of a definite period of time after sight or acceptance or at a fixed date or dates or at a time or times readily ascertainable at the time the promise or order is issued, subject to rights of (i) prepayment, (ii) acceleration, (iii) extension at the option of the holder, or (iv) extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event.

(c) If an instrument, payable at a fixed date, is also payable upon demand made before the fixed date, the instrument is payable on demand until the fixed date and, if demand for payment is not made before that date, becomes payable at a definite time on the fixed date.

Source: L. 94: Entire article R&RE, p. 845, § 1, effective January 1, 1995.

Editor's note: This section is similar to former §§ 4-3-108 and 4-3-109 as they existed prior to 1994.

OFFICIAL COMMENT

This section is a restatement of former Section 3-108 and Section 3-109. Subsection (b) broadens former Section 3-109 somewhat by providing that a definite time includes a time readily ascertainable at the time the promise or order is issued. Subsection (b)(iii) and (iv) restates former Section 3-109(1)(d). It adopts the generally accepted rule that a clause providing for extension at the option of the holder, even without a time limit, does not affect negotiability since the holder is given only a right which the holder would have without the clause. If the extension is to be at the option of the maker or acceptor or is to be automatic, a definite time limit must be stated or the time of payment remains uncertain and the order or promise is not a negotiable instrument. If a definite time limit is stated, the effect upon certainty of time of payment is the same as if the instrument were made payable at the ultimate date with a term providing for acceleration.

ANNOTATION

I. GENERAL CONSIDERATION.

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

A note fixing no date for payment is payable on demand, as provided by this section. Thompson v. Hilleweart, 137 Colo. 107, 321 P.2d 623 (1958).

Suit may be filed and recovery had on a demand note without a formal demand, the filing of the suit constituting the demand. Thompson v. Hilleweart, 137 Colo. 107, 321 P.2d 623 (1958).

Where notes are payable on demand, the statute of limitations commences to run on the date of execution of such note. Kirby v. Bourg, 165 Colo. 500, 440 P.2d 151 (1968).

A note, secured by a chattel mortgage and payable "on demand after date", but containing a marginal notation when signed stating that note is due at a date six months later, is not due after date of execution, since the marginal notation must be construed with the mortgage as to a creditor with notice. Whittier v. First Nat'l Bank, 73 Colo. 153, 214 P. 536 (1923).

The words "temporary loan" following the word "due" do not fix a date for payment

other than on demand, as such words are no part of the promise to pay, constituting nothing more than a reference for the holder, and, if omitted, would not impair or change the obligation. Thompson v. Hilleweart, 137 Colo. 107, 321 P.2d 623 (1958).

When a promissory note is payable on a future event that does not occur, the note is payable within a reasonable time. People v. Garnett, 725 P.2d 1149 (Colo. 1986).

Applied in West Greeley Nat'l Bank v. Wygant, 650 P.2d 1339 (Colo. App. 1982).

II. ACCELERATION.

A negotiable instrument is not rendered nonnegotiable by provisions for an option of payment before maturity. Cowing v. Cloud, 16 Colo. App. 326, 65 P. 417 (1901).

Provision for acceleration of maturity for nonpayment of installments or interest is recognized as valid by this section. Axelson v. Dailey Coop. Co., 88 Colo. 555, 298 P. 957 (1931).

Acceleration clauses premised upon default in payment are enforceable. Smith v. Certified Realty Corp., 41 Colo. App. 170, 585 P.2d 293 (1978), aff'd, 198 Colo. 222, 597 P.2d 1043 (1979).

Notice is required only where provided. Where a promissory note provides for acceleration in default of installments or interest payments, the maker is not entitled to notice of such a demand unless specifically provided for. Hendron v. Bolander, 101 Colo. 414, 74 P.2d 706 (1937).

Where a note contains an acceleration clause, the payee may waive this option by failing to exercise it or by accepting payments upon default in installments. Barday v. Steinbaugh, 130 Colo. 10, 272 P.2d 657 (1954).

Where a note contains an acceleration clause, the payee may be estopped. Where on an installment note with an acceleration clause, payments are customarily made and accepted after they are due, the holder is estopped to take advantage of the acceleration clause upon the failure to pay the remaining balance on the due date. Ashback v. Wenzel, 141 Colo. 35, 346 P.2d 295 (1959).

Acceleration clause in mortgage does not apply to note. A clause in a mortgage accelerating full payment of the principal upon failure to pay interest when due cannot be taken advantage of in an action on the note, inasmuch as such an acceleration clause accelerates the due date only in foreclosure proceedings. Spears v. Cook, 85 Colo. 318, 275 P. 907 (1929).

No right to cure default in suit on note only. Where suit after default in payment is on the note only and the creditor does not bring an action to foreclose on the security, the acceleration clause in the note is enforceable, and the debtor has no statutory or equitable right to cure the money default. Smith v. Certified Realty Corp., 41 Colo. App. 170, 585 P.2d 293 (1978), aff'd, 198 Colo. 222, 597 P.2d 1043 (1979).

III. EXTENSION.

Inclusion of an extension of time clause in a promissory note does not destroy the negotiable character of the note. Longmont Nat'l Bank v. Loukonen, 53 Colo. 489, 127 P. 947 (1912).

Where a note provides for an indefinite extension at the uncontrolled discretion of the maker, it is nonnegotiable. United States v. General Res., Ltd., 204 F. Supp. 872 (D. Colo. 1962).

Burden of proof where payee extends. Where a note contains a clause providing that the maker will agree to an extension of time for payment and the payee executes an extension which tolls the statute of limitations, the payee has the burden of proving that the extension was made with the knowledge and consent of the maker. Am. Medical & Dental Ass'n v. Grant, 87 Colo. 183, 285 P. 1099 (1930).

Between the maker and payee of a note, an oral agreement for extending the time of payment is enforceable; such agreement is supported by sufficient consideration by a promise to pay interest during the time of extension. Drescher v. Fulham, 11 Colo. App. 62, 52 P. 685 (1898).

An oral agreement for extending the time of payment releases the surety from his obligation. Drescher v. Fulham, 11 Colo. App. 62, 52 P. 685 (1898).

4-3-109. Payable to bearer or to order. (a) A promise or order is payable to bearer if it:

(1) States that it is payable to bearer or to the order of bearer or otherwise indicates that the person in possession of the promise or order is entitled to payment;

(2) Does not state a payee; or

(3) States that it is payable to or to the order of cash or otherwise indicates that it is not payable to an identified person.

(b) A promise or order that is not payable to bearer is payable to order if it is payable (i) to the order of an identified person or (ii) to an identified person or order. A promise or order that is payable to order is payable to the identified person.

(c) An instrument payable to bearer may become payable to an identified person if it is

specially indorsed pursuant to section 4-3-205 (a). An instrument payable to an identified person may become payable to bearer if it is indorsed in blank pursuant to section 4-3-205 (b).

Source: L. 94: Entire article R&RE, p. 845, § 1, effective January 1, 1995.

Editor's note: This section is similar to former §§ 4-3-110 and 4-3-111 as they existed prior to 1994.

OFFICIAL COMMENT

1. Under Section 3-104(a), a promise or order cannot be an instrument unless the instrument is payable to bearer or to order when it is issued or unless Section 3-104(c) applies. The terms "payable to bearer" and "payable to order" are defined in Section 3-109. The quoted terms are also relevant in determining how an instrument is negotiated. If the instrument is payable to bearer it can be negotiated by delivery alone. Section 3-201(b). An instrument that is payable to an identified person cannot be negotiated without the indorsement of the identified person. Section 3-201(b). An instrument payable to order is payable to an identified person. Section 3-109(b). Thus, an instrument payable to order requires the indorsement of the person to whose order the instrument is payable.

2. Subsection (a) states when an instrument is payable to bearer. An instrument is payable to bearer if it states that it is payable to bearer, but some instruments use ambiguous terms. For example, check forms usually have the words "to the order of" printed at the beginning of the line to be filled in for the name of the payee. If the drawer writes in the word "bearer" or "cash," the check reads "to the order of bearer" or "to the order of cash." In each case the check is payable to bearer. Sometimes the drawer will write the name of the payee "John Doe" but will add the words "or bearer." In that case the check is payable to bearer. Subsection (a). Under subsection (b), if an instrument is payable to bearer it can't be payable to order. This is different from former Section 3-110(3). An instrument that purports to be payable both to order and bearer states contradictory terms. A transferee of the instrument should be able to rely on the bearer term and acquire rights as a holder without obtaining the indorsement of the identified payee. An instrument is also payable to bearer if it does not state a payee. Instruments that do not state a payee are in most cases incomplete instruments. In some cases the drawer of a check may deliver or mail it to the person to be paid without filling in the line for the name of the payee. Under subsection (a) the check is payable to bearer when it is sent or delivered. It is also an incomplete instrument. This case is discussed in Comment 2 to Section 3-115. Subsection (a)(3) contains the words "otherwise indicates that it is not payable to an identified person." The quoted words are meant to cover uncommon cases in which an instrument indicates that it is not meant to be payable to a specific person. Such an instrument is treated like a check payable to "cash." The quoted words are not meant to apply to an instrument stating that it is payable to an identified person such as "ABC Corporation" if ABC Corporation is a nonexistent company. Although the holder of the check cannot be the nonexistent company, the instrument is not payable to bearer. Negotiation of such an instrument is governed by Section 3-404(b).

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

A check payable to "the royal consulate of Italy" is not payable to bearer but to the foreign consul. Scala v. Miners & Merchants Bank, 64 Colo. 185, 171 P. 752 (1918) (decided under repealed laws antecedent to CSA, C. 112, § 9, negotiable instruments law).

Effect of treating order paper as bearer paper. When a drawer of a check names a specific payee, the check becomes order rather than bearer paper. If a bank chooses to treat such checks as bearer paper, it acts at its own peril and may be liable for negligence if it misapplies the proceeds of the check. Arvada Hardwood Floor Co. v. James, 638 P.2d 828 (Colo. App. 1981).

4-3-110. Identification of person to whom instrument is payable. (a) The person to whom an instrument is initially payable is determined by the intent of the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument. The instrument is payable to the person intended by the signer even if that person is identified in the instrument by a name or other identification that is not that of the intended person.

If more than one person signs in the name or behalf of the issuer of an instrument and all the signers do not intend the same person as payee, the instrument is payable to any person intended by one or more of the signers.

(b) If the signature of the issuer of an instrument is made by automated means, such as a check-writing machine, the payee of the instrument is determined by the intent of the person who supplied the name or identification of the payee, whether or not authorized to do so.

(c) A person to whom an instrument is payable may be identified in any way, including by name, identifying number, office, or account number. For the purpose of determining the holder of an instrument, the following rules apply:

(1) If an instrument is payable to an account and the account is identified only by number, the instrument is payable to the person to whom the account is payable. If an instrument is payable to an account identified by number and by the name of a person, the instrument is payable to the named person, whether or not that person is the owner of the account identified by number.

(2) If an instrument is payable to:

(i) A trust, an estate, or a person described as trustee or representative of a trust or estate, the instrument is payable to the trustee, the representative, or a successor of either, whether or not the beneficiary or estate is also named;

(ii) A person described as agent or similar representative of a named or identified person, the instrument is payable to the represented person, the representative, or a successor of the representative;

(iii) A fund or organization that is not a legal entity, the instrument is payable to a representative of the members of the fund or organization; or

(iv) An office or to a person described as holding an office, the instrument is payable to the named person, the incumbent of the office, or a successor to the incumbent.

(d) If an instrument is payable to two or more persons alternatively, it is payable to any of them and may be negotiated, discharged, or enforced by any or all of them in possession of the instrument. If an instrument is payable to two or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them. If an instrument payable to two or more persons is ambiguous as to whether it is payable to the persons alternatively, the instrument is payable to the persons alternatively.

Source: L. 94: Entire article R&RE, p. 845, § 1, effective January 1, 1995.

Editor's note: This section is similar to former §§ 4-3-116 and 4-3-117 as they existed prior to 1994.

OFFICIAL COMMENT

1. Section 3-110 states rules for determining the identity of the person to whom an instrument is initially payable if the instrument is payable to an identified person. This issue usually arises in a dispute over the validity of an indorsement in the name of the payee. Subsection (a) states the general rule that the person to whom an instrument is payable is determined by the intent of "the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument." "Issuer" means the maker or drawer of the instrument. Section 3-105(c). If X signs a check as drawer of a check on X's account, the intent of X controls. If X, as President of Corporation, signs a check as President in behalf of Corporation as drawer, the intent of X controls. If X forges Y's signature as drawer of a check, the intent of X also controls. Under Section 3-103(a)(3), Y is referred to as the drawer of the check because the signing of Y's name identifies Y as the drawer. But since Y's signature was forged Y has no liability as drawer (Section 3-403(a)) unless some other provision of Article 3 or Article 4 makes Y liable. Since X, even though unauthorized, signed in the name of Y as issuer, the intent of X determines to whom the check is payable.

In the case of a check payable to "John Smith," since there are many people in the world named "John Smith" it is not possible to identify the payee of the check unless there is some further identification or the intention of the drawer is determined. Name alone is sufficient under subsection (a), but the intention of the drawer determines which John Smith is the person to whom the check is payable. The same issue is presented in cases of misdescriptions of the payee. The drawer intends to pay a person

known to the drawer as John Smith. In fact that person's name is James Smith or John Jones or some other entirely different name. If the check identifies the payee as John Smith, it is nevertheless payable to the person intended by the drawer. That person may indorse the check in either the name John Smith or the person's correct name or in both names. Section 3-204(d). The intent of the drawer is also controlling in fictitious payee cases. Section 3-404(b). The last sentence of subsection (a) refers to rare cases in which the signature of an organization requires more than one signature and the persons signing on behalf of the organization do not all intend the same person as payee. Any person intended by a signer for the organization is the payee and an indorsement by that person is an effective indorsement.

Subsection (b) recognizes the fact that in a large number of cases there is no human signer of an instrument because the instrument, usually a check, is produced by automated means such as a check-writing machine. In that case, the relevant intent is that of the person who supplied the name of the payee. In most cases that person is an employee of the drawer, but in some cases the person could be an outsider who is committing a fraud by introducing names of payees of checks into the system that produces the checks. A check-writing machine is likely to be operated by means of a computer in which is stored information as to name and address of the payee and the amount of the check. Access to the computer may allow production of fraudulent checks without knowledge of the organization that is the issuer of the check. Section 3-404(b) is also concerned with this issue. See Case #4 in Comment 2 to Section 3-404.

2. Subsection (c) allows the payee to be identified in any way including the various ways stated. Subsection (c)(1) relates to instruments payable to bank accounts. In some cases the account might be identified by name and number, and the name and number might refer to different persons. For example, a check is payable to "X Corporation Account No. 12345 in Bank of Podunk." Under the last sentence of subsection (c)(1), this check is payable to X Corporation and can be negotiated by X Corporation even if Account No. 12345 is some other person's account or the check is not deposited in that account. In other cases the payee is identified by an account number and the name of the owner of the account is not stated. For example, Debtor pays Creditor by issuing a check drawn on Payor Bank. The check is payable to a bank account owned by Creditor but identified only by number. Under the first sentence of subsection (c)(1) the check is payable to Creditor and, under Section 1-201(20), Creditor becomes the holder when the check is delivered. Under Section 3-201(b), further negotiation of the check requires the indorsement of Creditor. But under Section 4-205(a), if the check is taken by a depositary bank for collection, the bank may become a holder without the indorsement. Under Section 3-102(b), provisions of Article 4 prevail over those of Article 3. The depositary bank warrants that the amount of the check was credited to the payee's account.

3. Subsection (c)(2) replaces former Section 3-117 and subsections (1)(e), (f), and (g) of former Section 3-110. This provision merely determines who can deal with an instrument as a holder. It does not determine ownership of the instrument or its proceeds. Subsection (c)(2)(i) covers trusts and estates. If the instrument is payable to the trust or estate or to the trustee or representative of the trust or estate, the instrument is payable to the trustee or representative or any successor. Under subsection (c)(2)(ii), if the instrument states that it is payable to Doe, President of X Corporation, either Doe or X Corporation can be holder of the instrument. Subsection (c)(2)(iii) concerns informal organizations that are not legal entities such as unincorporated clubs and the like. Any representative of the members of the organization can act as holder. Subsection (c)(2)(iv) applies principally to instruments payable to public offices such as a check payable to County Tax Collector.

4. Subsection (d) replaces former Section 3-116. An instrument payable to X or Y is governed by the first sentence of subsection (d). An instrument payable to X and Y is governed by the second sentence of subsection (d). If an instrument is payable to X or Y, either is the payee and if either is in possession that person is the holder and the person entitled to enforce the instrument. Section 3-301. If an instrument is payable to X and Y, neither X nor Y acting alone is the person to whom the instrument is payable. Neither person, acting alone, can be the holder of the instrument. The instrument is "payable to an identified person." The "identified person" is X and Y acting jointly. Section 3-109(b) and Section 1-102(5)(a). Thus, under Section 1-201(20) X or Y, acting alone, cannot be the holder or the person entitled to enforce or negotiate the instrument because neither, acting alone, is the identified person stated in the instrument.

The third sentence of subsection (d) is directed to cases in which it is not clear whether an instrument is payable to multiple payees alternatively. In the case of ambiguity persons dealing with the instrument should be able to rely on the indorsement of a single payee. For example, an instrument payable to X and/or Y is treated like an instrument payable to X or Y.

ANNOTATION

I. General Consideration.
II. In Alternative.
III. Not in Alternative.

I. GENERAL CONSIDERATION.

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

This section implies an exception to the parol evidence rule even if a negotiable instrument is clear on its face as to whom the payee is. Electrical Distribs., Inc. v. SFR, Inc., 166 F.3d 1074 (10th Cir. 1999).

A promissory note drawn to the order of "A or B" creates alternative and not joint payees. Reese v. Lietzan, 160 Colo. 253, 419 P.2d 959 (1966).

While there are cases in which the disjunctive "or" has been construed as the conjunctive "and" so as to create a joint rather than an alternative interest, unique and exceptional circumstances have always accompanied the result. Reese v. Leitzan, 160 Colo. 253, 419 P.2d 959 (1966).

Effect of treating order paper as bearer paper. When a drawer of a check names a specific payee, the check becomes order rather than bearer paper. If a bank chooses to treat such checks as bearer paper, it acts at its own peril and may be liable for negligence if it misapplies the proceeds of the check. Arvada Hardwood Floor Co. v. James, 638 P.2d 828 (Colo. App. 1981).

II. IN ALTERNATIVE.

The phrase "and/or" in written instruments means either "and" or "or", or both. Denver-Metro Collections, Inc. v. Kleeman, 30 Colo. App. 218, 491 P.2d 64 (1971).

Where the payees of notes are listed as A "and/or" B, under the provisions of this section there would be no question of the authority of a singular payee to assign the notes, since where the phrase "and/or" is used, then either payee, or both, may enforce the note as written. Denver-Metro Collections, Inc. v. Kleeman, 30 Colo. App. 218, 491 P.2d 64 (1971).

III. NOT IN ALTERNATIVE.

Law reviews. For comment on Am. Nat'l Bank v. First Nat'l Bank appearing below, see 32 Dicta 185 (1955) and 27 Rocky Mt. L. Rev. 347 (1955).

Under common law and N.I.L. the negotiable instruments law adopted the common-law rule providing that where a check is payable to the order of two or more persons who are not partners, all of them had to indorse unless the one so doing had authority to indorse for the other payees, and this joint indorsement was necessary for a complete negotiation; where one of the payees failed to indorse, the negotiability of the check was completely destroyed. Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954).

In the absence of a necessary indorsement by a co-payee the instrument is nonnegotiable and not subject to cashing. F. R. Orr Constr. Co. v. Ready Mixed Concrete Co., 28 Colo. App. 273, 472 P.2d 193 (1970).

Holder acquires only a chose in action. The failure of one of two joint payees to indorse destroys the negotiability of a check, and the holder of the check acquires only as an assignee of a nonnegotiable chose in action the interest of the payee who did indorse; as such an assignee, his interest in the proceeds of the check is to be determined. Skinner v. Mortgage Inv. Co., 165 Colo. 241, 438 P.2d 504 (1968). See Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954).

The drawee bank is authorized to pay out funds belonging to its depositor when, and only when, the check is indorsed by the payees therein, or by persons who have satisfied it or the bank to which the check is presented for payment of their right to the proceeds. Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954).

In the absence of actual fault on the part of the drawee, its failure to observe the fact of the absence of the indorsement of one of the payees, due entirely to the fault or neglect of the holder, will not preclude its recovery. Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954).

As a greater duty is imposed on the holder. The absence of an indorsement by the holder is as serious, if not more so, than a forged indorsement; the first is easily discernible while the other is the result of an error in the identification of the payee. Consequently, if it is the duty of the bank cashing the check to know to a positive certainty the identity of the payee named therein and its failure so to do imposes a duty of reimbursing the drawee, it seems clear that the failure to secure the indorsement of all of the payees imposes an even greater duty on the holder. Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954).

4-3-111. Place of payment. Except as otherwise provided for items in article 4 of this title, an instrument is payable at the place of payment stated in the instrument. If no place of payment is stated, an instrument is payable at the address of the drawee or maker stated

in the instrument. If no address is stated, the place of payment is the place of business of the drawee or maker. If a drawee or maker has more than one place of business, the place of payment is any place of business of the drawee or maker chosen by the person entitled to enforce the instrument. If the drawee or maker has no place of business, the place of payment is the residence of the drawee or maker.

Source: L. 94: Entire article R&RE, p. 847, § 1, effective January 1, 1995.

OFFICIAL COMMENT

If an instrument is payable at a bank in the United States, Section 3-501(b)(1) states that presentment must be made at the place of payment, i.e. the bank. The place of presentment of a check is governed by Regulation CC § 229.36.

ANNOTATION

When a note is made payable at a bank, it is considered a sufficient presentment of it if it is actually in the bank at maturity, ready to be delivered to anyone who may be entitled to it on payment. Such is the general rule, whether the bank is the holder of the note or merely an agent for collection. De La Vergne v. Globe Printing Co., 27 Colo. App. 308, 148 P. 923 (1915) (decided under repealed laws antecedent to CSA, C. 112, § 87, negotiable instruments law).

4-3-112. Interest. (a) Unless otherwise provided in the instrument, (i) an instrument is not payable with interest, and (ii) interest on an interest-bearing instrument is payable from the date of the instrument.

(b) Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable cannot be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues.

Source: L. 94: Entire article R&RE, p. 847, § 1, effective January 1, 1995.

OFFICIAL COMMENT

1. Under Section 3-104(a) the requirement of a "fixed amount" applies only to principal. The amount of interest payable is that described in the instrument. If the description of interest in the instrument does not allow for the amount of interest to be ascertained, interest is payable at the judgment rate. Hence, if an instrument calls for interest, the amount of interest will always be determinable. If a variable rate of interest is prescribed, the amount of interest is ascertainable by reference to the formula or index described or referred to in the instrument. The last sentence of subsection (b) replaces subsection (d) of former Section 3-118.

2. The purpose of subsection (b) is to clarify the meaning of "interest" in the introductory clause of Section 3-104(a). It is not intended to validate a provision for interest in an instrument if that provision violates other law.

4-3-113. Date of instrument. (a) An instrument may be antedated or postdated. The date stated determines the time of payment if the instrument is payable at a fixed period after date. Except as provided in section 4-4-401 (c), an instrument payable on demand is not payable before the date of the instrument.

(b) If an instrument is undated, its date is the date of its issue or, in the case of an unissued instrument, the date it first comes into possession of a holder.

Source: L. 94: Entire article R&RE, p. 847, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-114 as it existed prior to 1994.

OFFICIAL COMMENT

This section replaces former Section 3-114. Subsections (1) and (3) of former Section 3-114 are deleted as unnecessary. Section 3-113(a) is based in part on subsection (2) of former Section 3-114. The rule that a demand instrument is not payable before the date of the instrument is subject to Section 4-401(c) which allows the payor bank to pay a postdated check unless the drawer has notified the bank of the postdating pursuant to a procedure prescribed in that subsection. With respect to an undated instrument, the date is the date of issue.

ANNOTATION

I. GENERAL CONSIDERATION.

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

II. DATING, ANTEDATING, AND POSTDATING.

Lack of timely presentment of check. Where stolen check bore a 1971 date and was not cashed until 1973, when the time for presentment had long since passed, the lack of timely presentment would not have destroyed its negotiability as the negotiability of an instrument is not affected by the fact that it is undated, antedated, or postdated. Thus, the stolen check indorsed by accused falls squarely within the terms of the forgery statute under which he was convicted. People v. Palmer, 189 Colo. 358, 540 P.2d 341 (1975).

The fact that an instrument is postdated does not render it void, but merely defers negotiability to a subsequent time. Gentry v. People, 166 Colo. 60, 441 P.2d 675 (1968) (decided under repealed § 95-1-12, C.R.S. 1963, negotiable instruments law).

Postdating of check does not make obligation conditional. The fact that a check is postdated does not qualify the check or make conditional the promissory obligation represented by the check. Esecson v. Bushnell, 663 P.2d 258 (Colo. App. 1983).

III. PRESUMPTION AS TO DATE.

Date presumption not applicable to fiduciary relationships. The general presumption of date of promissory notes is overcome by the specific presumption arising where there is a fiduciary relationship in which case the claimant must overcome, by evidence, the presumption of undue influence with which the transaction is tainted because of the existence of the fiduciary relationship. Arnold v. Abernethy, 134 Colo. 573, 307 P.2d 1106 (1957) (decided under repealed § 95-1-11, CRS 53, negotiable instruments law).

4-3-114. Contradictory terms of instrument. If an instrument contains contradictory terms, type-written terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers.

Source: L. 94: Entire article R&RE, p. 847, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-118 as it existed prior to 1994.

OFFICIAL COMMENT

Section 3-114 replaces subsections (b) and (c) of former Section 3-118.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Parol evidence is admissible to determine if reformation of instrument is appropriate where misrepresentations of legal effect of contract by assignee's attorney was alleged. Boyles Bros. Drilling v. Orion Indust., Ltd., 761 P.2d 278 (Colo. App. 1988).

Applies only to terms of instrument itself and not to an extraneous matter appearing on a document. Pueblo Bank & Trust Co. v. McMartin, 31 Colo. App. 546, 506 P.2d 759 (1972).

Applicable where a single amount, such as an amount of principal, is intended to be expressed both in figures an in words and there is a conflict between the figures and the words, or an ambiguity in either the figures or the words used. Mees v. Canino, 31 Colo. App. 514, 503 P.2d 1036 (1972).

Where the word "renewed" is stamped across face of note, but handwritten words "stamped in error" appears next to stamp, and there is no evidence as to who made latter entry or when it was done, it is error to instruct jury that written words on note are controlling. Pueblo Bank & Trust Co. v. McMartin, 31 Colo. App. 546, 506 P.2d 759 (1972).

When an installment note is written for $27,000 and the note states that the maker promises to pay "Two Hundred Twenty-Five" dollars, "said principal payable on the first day of each and every month commencing April 1, 1970," the amount is not controlled by the written figure but is in the principal amount of $27,000 and not $225. Mees v. Canino, 31 Colo. App. 514, 503 P.2d 1036 (1972).

4-3-115. Incomplete instrument. (a) "Incomplete instrument" means a signed writing, whether or not issued by the signer, the contents of which show at the time of signing that it is incomplete but that the signer intended it to be completed by the addition of words or numbers.

(b) Subject to subsection (c) of this section, if an incomplete instrument is an instrument under section 4-3-104, it may be enforced according to its terms if it is not completed, or according to its terms as augmented by completion. If an incomplete instrument is not an instrument under section 4-3-104, but, after completion, the requirements of section 4-3-104 are met, the instrument may be enforced according to its terms as augmented by completion.

(c) If words or numbers are added to an incomplete instrument without authority of the signer, there is an alteration of the incomplete instrument under section 4-3-407.

(d) The burden of establishing that words or numbers were added to an incomplete instrument without authority of the signer is on the person asserting the lack of authority.

Source: L. 94: Entire article R&RE, p. 847, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-115 as it existed prior to 1994.

OFFICIAL COMMENT

1. This section generally carries forward the rules set out in former Section 3-115. The term "incomplete instrument" applies both to an "instrument," i.e. a writing meeting all the requirements of Section 3-104, and to a writing intended to be an instrument that is signed but lacks some element of an instrument. The test in both cases is whether the contents show that it is incomplete and that the signer intended that additional words or numbers be added.

2. If an incomplete instrument meets the requirements of Section 3-104 and is not completed it may be enforced in accordance with its terms. Suppose, in the following two cases, that a note delivered to the payee is incomplete solely because a space on the pre-printed note form for the due date is not filled in:

Case #1. If the incomplete instrument is never completed, the note is payable on demand. Section 3-108(a)(ii). However, if the payee and the maker agreed to a due date, the maker may have a defense under Section 3-117 if demand for payment is made before the due date agreed to by the parties.

Case #2. If the payee completes the note by filling in the due date agreed to by the parties, the note is payable on the due date stated. However, if the due date filled in was not the date agreed to by the parties there is an alteration of the note. Section 3-407 governs the case.

Suppose Debtor pays Creditor by giving Creditor a check on which the space for the name of the payee is left blank. The check is an instrument but it is incomplete. The check is enforceable in its incomplete form and it is payable to bearer because it does not state a payee. Section 3-109(a)(2). Thus, Creditor is a holder of the check. Normally in this kind of case Creditor would simply fill in the space with Creditor's name. When that occurs the check becomes payable to the Creditor.

3. In some cases the incomplete instrument does not meet the requirements of Section 3-104. An example is a check with the amount not filled in. The check cannot be enforced until the amount is filled in. If the payee fills in an amount authorized by the drawer the check meets the requirements of Section 3-104 and is enforceable as completed. If the payee fills in an unauthorized amount there is an alteration of the check and Section 3-407 applies.

4. Section 3-302(a)(1) also bears on the problem of incomplete instruments. Under that

section a person cannot be a holder in due course of the instrument if it is so incomplete as to call into question its validity. Subsection (d) of Section 3-115 is based on the last clause of subsection (2) of former Section 3-115.

ANNOTATION

No ratification by principal. Where an agent gives a joint note of his principal and himself and deposits the money borrowed to the principal's credit, all without the principal's knowledge, to make good a shortage in the agent's account, there is no ratification by the principal, although the money is used for the principal's account. Rizzuto v. R. W. English Lumber Co., 44 Colo. 413, 98 P. 728 (1908) (decided under repealed laws antecedent to CSA, C. 112, § 15, negotiable instruments law).

4-3-116. Joint and several liability; contribution. (a) Except as otherwise provided in the instrument, two or more persons who have the same liability on an instrument as makers, drawers, acceptors, indorsers who indorse as joint payees, or anomalous indorsers are jointly and severally liable in the capacity in which they sign.

(b) Except as provided in section 4-3-419 (e) or by agreement of the affected parties, a party having joint and several liability who pays the instrument is entitled to receive from any party having the same joint and several liability contribution in accordance with applicable law.

(c) Discharge of one party having joint and several liability by a person entitled to enforce the instrument does not affect the right under subsection (b) of this section of a party having the same joint and several liability to receive contribution from the party discharged.

Source: L. 94: Entire article R&RE, p. 848, § 1, effective January 1, 1995.

OFFICIAL COMMENT

1. Subsection (a) replaces subsection (e) of former Section 3-118. Subsection (b) states contribution rights of parties with joint and several liability by referring to applicable law. But subsection (b) is subject to Section 3-419(e). If one of the parties with joint and several liability is an accommodation party and the other is the accommodated party, Section 3-419(e) applies. Subsection (c) deals with discharge. The discharge of a jointly and severally liable obligor does not affect the right of other obligors to seek contribution from the discharged obligor.

2. Indorsers normally do not have joint and several liability. Rather, an earlier indorser has liability to a later indorser. But indorsers can have joint and several liability in two cases. If an instrument is payable to two payees jointly, both payees must indorse. The indorsement is a joint indorsement and the indorsers have joint and several liability and subsection (b) applies. The other case is that of two or more anomalous indorsers. The term is defined in Section 3-205(d). An anomalous indorsement normally indicates that the indorser signed as an accommodation party. If more than one accommodation party indorses a note as an accommodation to the maker, the indorsers have joint and several liability and subsection (b) applies.

ANNOTATION

Promissory note signed by two persons "I promise to pay" is joint and several. See Ullery v. Brohm, 20 Colo. App. 389, 79 P. 180 (1904) (decided under repealed laws antecedent to CSA, C. 112, § 17, negotiable instruments law).

4-3-117. Other agreements affecting instrument. Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a party to an instrument to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented, or nullified by an agreement under this section, the agreement is a defense to the obligation.

Source: L. 94: Entire article R&RE, p. 848, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-119 as it existed prior to 1994.

OFFICIAL COMMENT

1. The separate agreement might be a security agreement or mortgage or it might be an agreement that contradicts the terms of the instrument. For example, a person may be induced to sign an instrument under an agreement that the signer will not be liable on the instrument unless certain conditions are met. Suppose X requested credit from Creditor who is willing to give the credit only if an acceptable accommodation party will sign the note of X as co-maker. Y agrees to sign as co-maker on the condition that Creditor also obtain the signature of Z as co-maker. Creditor agrees and Y signs as co-maker with X. Creditor fails to obtain the signature of Z on the note. Under Sections 3-412 and 3-419(b), Y is obliged to pay the note, but Section 3-117 applies. In this case, the agreement modifies the terms of the note by stating a condition to the obligation of Y to pay the note. This case is essentially similar to a case in which a maker of a note is induced to sign the note by fraud of the holder. Although the agreement that Y not be liable on the note unless Z also signs may not have been fraudulently made, a subsequent attempt by Creditor to require Y to pay the note in violation of the agreement is a bad faith act. Section 3-117, in treating the agreement as a defense, allows Y to assert the agreement against Creditor, but the defense would not be good against a subsequent holder in due course of the note that took it without notice of the agreement. If there cannot be a holder in due course because of Section 3-106(d), a subsequent holder that took the note in good faith, for value and without knowledge of the agreement would not be able to enforce the liability of Y. This result is consistent with the risk that a holder not in due course takes with respect to fraud in inducing issuance of an instrument.

2. The effect of merger or integration clauses to the effect that a writing is intended to be the complete and exclusive statement of the terms of the agreement or that the agreement is not subject to conditions is left to the supplementary law of the jurisdiction pursuant to Section 1-103. Thus, in the case discussed in Comment 1, whether Y is permitted to prove the condition to Y's obligation to pay the note is determined by that law. Moreover, nothing in this section is intended to validate an agreement which is fraudulent or void as against public policy, as in the case of a note given to deceive a bank examiner.

ANNOTATION

Reference to independent agreement used to be considered as destroying negotiability. Abercrombie v. Bear Canon Coal Co., 86 Colo. 169, 279 P. 42 (1929); Bank of Kimball v. Rostek, 161 Colo. 584, 423 P.2d 579 (1967) (decided under repealed § 95-1-1, C.R.S. 1963, and laws antecedent to CSA, C. 112, § 1, negotiable instruments law).

4-3-118. Statute of limitations. (a) Except as provided in subsection (e) of this section, an action to enforce the obligation of a party to pay a note payable at a definite time must be commenced within six years after the due date or dates stated in the note or, if a due date is accelerated, within six years after the accelerated due date.

(b) Except as provided in subsection (d) or (e) of this section, if demand for payment is made to the maker of a note payable on demand, an action to enforce the obligation of a party to pay the note must be commenced within six years after the demand. If no demand for payment is made to the maker, an action to enforce the note is barred if neither principal nor interest on the note has been paid for a continuous period of ten years.

(c) Except as provided in subsection (d) of this section, an action to enforce the obligation of a party to an unaccepted draft to pay the draft must be commenced within three years after dishonor of the draft or ten years after the date of the draft, whichever period expires first.

(d) An action to enforce the obligation of the acceptor of a certified check or the issuer of a teller's check, cashier's check, or traveler's check must be commenced within three years after demand for payment is made to the acceptor or issuer, as the case may be.

(e) An action to enforce the obligation of a party to a certificate of deposit to pay the instrument must be commenced within six years after demand for payment is made to the maker, but if the instrument states a due date and the maker is not required to pay before

that date, the six-year period begins when a demand for payment is in effect and the due date has passed.

(f) An action to enforce the obligation of a party to pay an accepted draft, other than a certified check, must be commenced (i) within six years after the due date or dates stated in the draft or acceptance if the obligation of the acceptor is payable at a definite time, or (ii) within six years after the date of the acceptance if the obligation of the acceptor is payable on demand.

(g) Unless governed by other law regarding claims for indemnity or contribution, an action (i) for conversion of an instrument, for money had and received, or like action based on conversion, (ii) for breach of warranty, or (iii) to enforce an obligation, duty, or right arising under this article and not governed by this section must be commenced within three years after the cause of action accrues.

Source: L. 94: Entire article R&RE, p. 848, § 1, effective January 1, 1995.

OFFICIAL COMMENT

1. Section 3-118 differs from former Section 3-122, which states when a cause of action accrues on an instrument. Section 3-118 does not define when a cause of action accrues. Accrual of a cause of action is stated in other sections of Article 3 such as those that state the various obligations of parties to an instrument. The only purpose of Section 3-118 is to define the time within which an action to enforce an obligation, duty, or right arising under Article 3 must be commenced. Section 3-118 does not attempt to state all rules with respect to a statute of limitations. For example, the circumstances under which the running of a limitations period may be tolled is left to other law pursuant to Section 1-103.

2. The first six subsections apply to actions to enforce an obligation of any party to an instrument to pay the instrument. This changes present law in that indorsers who may become liable on an instrument after issue are subject to a period of limitations running from the same date as that of the maker or drawer. Subsections (a) and (b) apply to notes. If the note is payable at a definite time, a six-year limitations period starts at the due date of the note, subject to prior acceleration. If the note is payable on demand, there are two limitations periods. Although a note payable on demand could theoretically be called a day after it was issued, the normal expectation of the parties is that the note will remain outstanding until there is some reason to call it. If the law provides that the limitations period does not start until demand is made, the cause of action to enforce it may never be barred. On the other hand, if the limitations period starts when demand for payment may be made, i.e. at any time after the note was issued, the payee of a note on which interest or portions of principal are being paid could lose the right to enforce the note even though it was treated as a continuing obligation by the parties. Some demand notes are not enforced because the payee has forgiven the debt. This is particularly true in family and other noncommercial transactions. A demand note found after the death of the payee may be presented for payment many years after it was issued. The maker may be a relative and it may be difficult to determine whether the note represents a real or a forgiven debt. Subsection (b) is designed to bar notes that no longer represent a claim to payment and to require reasonably prompt action to enforce notes on which there is default. If a demand for payment is made to the maker, a six-year limitations period starts to run when demand is made. The second sentence of subsection (b) bars an action to enforce a demand note if no demand has been made on the note and no payment of interest or principal has been made for a continuous period of 10 years. This covers the case of a note that does not bear interest or a case in which interest due on the note has not been paid. This kind of case is likely to be a family transaction in which a failure to demand payment may indicate that the holder did not intend to enforce the obligation but neglected to destroy the note. A limitations period that bars stale claims in this kind of case is appropriate if the period is relatively long.

3. Subsection (c) applies primarily to personal uncertified checks. Checks are payment instruments rather than credit instruments. The limitations period expires three years after the date of dishonor or 10 years after the date of the check, whichever is earlier. Teller's checks, cashier's checks, certified checks, and traveler's checks are treated differently under subsection (d) because they are commonly treated as cash equivalents. A great delay in presenting a cashier's check for payment in most cases will occur because the check was mislaid during that period. The person to whom traveler's checks are issued may hold them indefinitely as a safe form of cash for use in an emergency. There is no compelling reason for barring the claim of the owner of the cashier's check or traveler's check. Under subsection (d) the claim is never

barred because the three-year limitations period does not start to run until demand for payment is made. The limitations period in subsection (d) in effect applies only to cases in which there is a dispute about the legitimacy of the claim of the person demanding payment.

4. Subsection (e) covers certificates of deposit. The limitations period of six years doesn't start to run until the depositor demands payment. Most certificates of deposit are payable on demand even if they state a due date. The effect of a demand for payment before maturity is usually that the bank will pay, but that a penalty will be assessed against the depositor in the form of a reduction in the amount of interest that is paid. Subsection (e) also provides for cases in which the bank has no obligation to pay until the due date. In that case the limitations period doesn't start to run until there is a demand for payment in effect and the due date has passed.

5. Subsection (f) applies to accepted drafts other than certified checks. When a draft is accepted it is in effect turned into a note of the acceptor. In almost all cases the acceptor will agree to pay at a definite time. Subsection (f) states that in that case the six-year limitations period starts to run on the due date. In the rare case in which the obligation of the acceptor is payable on demand, the six-year limitations period starts to run at the date of the acceptance.

6. Subsection (g) covers warranty and conversion cases and other actions to enforce obligations or rights arising under Article 3. A three-year period is stated and subsection (g) follows general law in stating that the period runs from the time the cause of action accrues. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

ANNOTATION

Law reviews. For article, "An Update of Appendices from Collecting Pre- and Post-Judgment Interest in Colorado", see 15 Colo. Law. 990 (1986).

Applied in Nagy v. Landau, 807 P.2d 1227 (Colo. App. 1990).

4-3-119. Notice of right to defend action. In an action for breach of an obligation for which a third person is answerable over pursuant to this article or article 4 of this title, the defendant may give the third person written notice of the litigation, and the person notified may then give similar notice to any other person who is answerable over. If the notice states (i) that the person notified may come in and defend and (ii) that failure to do so will bind the person notified in an action later brought by the person giving the notice as to any determination of fact common to the two litigations, the person notified is so bound unless after seasonable receipt of the notice the person notified does come in and defend.

Source: L. 94: Entire article R&RE, p. 849, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-803 as it existed prior to 1994.

OFFICIAL COMMENT

This section is a restatement of former Section 3-803.

ANNOTATION

Reference to independent agreement used to be considered as destroying negotiability. See Abercrombie v. Bear Canon Coal Co., 86 Colo. 169, 279 P. 42 (1929); Bank of Kimball v. Rostek, 161 Colo. 584, 423 P.2d 579 (1967) (decided under repealed § 95-1-1, C.R.S. 1963, and laws antecedent to CSA, C. 112, § 1, negotiable instruments law).

PART 2

NEGOTIATION, TRANSFER, AND INDORSEMENT

4-3-201. Negotiation. (a) "Negotiation" means a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder.

(b) Except for negotiation by a remitter, if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder. If an instrument is payable to bearer, it may be negotiated by transfer of possession alone.

Source: L. 94: Entire article R&RE, p. 850, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-202 as it existed prior to 1994.

OFFICIAL COMMENT

1. Subsections (a) and (b) are based in part on subsection (1) of former Section 3-202. A person can become holder of an instrument when the instrument is issued to that person, or the status of holder can arise as the result of an event that occurs after issuance. "Negotiation" is the term used in Article 3 to describe this post-issuance event. Normally, negotiation occurs as the result of a voluntary transfer of possession of an instrument by a holder to another person who becomes the holder as a result of the transfer. Negotiation always requires a change in possession of the instrument because nobody can be a holder without possessing the instrument, either directly or through an agent. But in some cases the transfer of possession is involuntary and in some cases the person transferring possession is not a holder. In defining "negotiation" former Section 3-202(1) used the word "transfer," an undefined term, and "delivery," defined in Section 1-201(14) to mean voluntary change of possession. Instead, subsections (a) and (b) use the term "transfer of possession" and, subsection (a) states that negotiation can occur by an involuntary transfer of possession. For example, if an instrument is payable to bearer and it is stolen by Thief or is found by Finder, Thief or Finder becomes the holder of the instrument when possession is obtained. In this case there is an involuntary transfer of possession that results in negotiation to Thief or Finder.

2. In most cases negotiation occurs by a transfer of possession by a holder or remitter. Remitter transactions usually involve a cashier's or teller's check. For example, Buyer buys goods from Seller and pays for them with a cashier's check of Bank that Buyer buys from Bank. The check is issued by Bank when it is delivered to Buyer, regardless of whether the check is payable to Buyer or to Seller. Section 3-105(a). If the check is payable to Buyer, negotiation to Seller is done by delivery of the check to Seller after it is indorsed by Buyer. It is more common, however, that the check when issued will be payable to Seller. In that case Buyer is referred to as the "remitter." Section 3-103(a)(11). The remitter, although not a party to the check, is the owner of the check until ownership is transferred to Seller by delivery. This transfer is a negotiation because Seller becomes the holder of the check when Seller obtains possession. In some cases Seller may have acted fraudulently in obtaining possession of the check. In those cases Buyer may be entitled to rescind the transfer to Seller because of the fraud and assert a claim of ownership to the check under Section 3-306 against Seller or a subsequent transferee of the check. Section 3-202(b) provides for rescission of negotiation, and that provision applies to rescission by a remitter as well as by a holder.

3. Other sections of Article 3 may modify the rule stated in the first sentence of subsection (b). See for example, Sections 3-404, 3-405, and 3-406.

ANNOTATION

I. General Consideration.
II. Negotiation.

I. GENERAL CONSIDERATION.

Law reviews. For comment on Am. Nat'l Bank v. First Nat'l Bank appearing below, see 32 Dicta 185 (1955) and 27 Rocky Mt. L. Rev. 347 (1955). For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Applied in Pay Center, Inc. v. Milton, 632 P.2d 642 (Colo. App. 1981).

Former § 4-3-202 applied in Barclay Receivables v. Mountain Majesty, Ltd., 903 P.2d 37 (Colo. App. 1995).

II. NEGOTIATION.

A promissory note payable to the order of a named person may be transferred by mere delivery; the assignee takes the legal title and may sue in his own name, but he takes subject to then-existing defenses of the maker. Best v. Rocky Mt. Nat'l Bank, 37 Colo. 149, 85 P. 1124 (1906); Bank of Bromfield v. McKinlay, 53 Colo. 279, 125 P. 493 (1912).

An allegation that the payee "indorsed and transferred" the note is a sufficient allegation of delivery. Louisville Coal Min. Co. v. Int'l. Trust Co., 18 Colo. App. 345, 71 P. 898 (1903).

Where negotiated to third bank. Where one draws a check on a foreign bank and deposits it with his local bank, receiving credit therefor, and this bank in turn negotiates it to a third bank for a valuable consideration, there is a sale to the latter, and it can maintain suit on the check against the original drawer. See Union Nat'l Bank v. Maines-Hough Motor Co., 70 Colo. 132, 197 P. 753 (1921); Manatee County State Bank v. Bruen-Fisher Fruit Co., 70 Colo. 342, 201 P. 560 (1921); First Nat'l Bank v. Bruen-Fisher Fruit Co., 70 Colo. 345, 201 P. 561 (1921). But see First Nat'l Bank v. Fleming State Bank, 74 Colo. 309, 221 P. 891 (1923); Scully v. Denver Nat'l Bank, 76 Colo. 227, 230 P. 610 (1924).

Applied in Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954).

4-3-202. Negotiation subject to rescission. (a) Negotiation is effective even if obtained (i) from an infant, a corporation exceeding its powers, or a person without capacity, (ii) by fraud, duress, or mistake, or (iii) in breach of duty or as part of an illegal transaction.

(b) To the extent permitted by other law, negotiation may be rescinded or may be subject to other remedies, but those remedies may not be asserted against a subsequent holder in due course or a person paying the instrument in good faith and without knowledge of facts that are a basis for rescission or other remedy.

Source: L. 94: Entire article R&RE, p. 850, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-207 as it existed prior to 1994.

OFFICIAL COMMENT

1. This section is based on former Section 3-207. Subsection (2) of former Section 3-207 prohibited rescission of a negotiation against holders in due course. Subsection (b) of Section 3-202 extends this protection to payor banks.

2. Subsection (a) applies even though the lack of capacity or the illegality, is of a character which goes to the essence of the transaction and makes it entirely void. It is inherent in the character of negotiable instruments that any person in possession of an instrument which by its terms is payable to that person or to bearer is a holder and may be dealt with by anyone as a holder. The principle finds its most extreme application in the well settled rule that a holder in due course may take the instrument even from a thief and be protected against the claim of the rightful owner. The policy of subsection (a) is that any person to whom an instrument is negotiated is a holder until the instrument has been recovered from that person's possession. The remedy of a person with a claim to an instrument is to recover the instrument by replevin or otherwise; to impound it or to enjoin its enforcement, collection or negotiation; to recover its proceeds from the holder; or to intervene in any action brought by the holder against the obligor. As provided in Section 3-305(c), the claim of the claimant is not a defense to the obligor unless the claimant defends the action.

3. There can be no rescission or other remedy against a holder in due course or a person

who pays in good faith and without notice, even though the prior negotiation may have been fraudulent or illegal in its essence and entirely void. As against any other party the claimant may have any remedy permitted by law. This section is not intended to specify what that remedy may be, or to prevent any court from imposing conditions or limitations such as prompt action or return of the consideration received. All such questions are left to the law of the particular jurisdiction. Section 3-202 gives no right that would not otherwise exist. The section is intended to mean that any remedies afforded by other law are cut off only by a holder in due course.

4-3-203. Transfer of instrument; rights acquired by transfer. (a) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.

(b) Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course, but the transferee cannot acquire rights of a holder in due course by a transfer, directly or indirectly, from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument.

(c) Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but negotiation of the instrument does not occur until the indorsement is made.

(d) If a transferor purports to transfer less than the entire instrument, negotiation of the instrument does not occur. The transferee obtains no rights under this article and has only the rights of a partial assignee.

Source: L. 94: Entire article R&RE, p. 850, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-201 as it existed prior to 1994.

OFFICIAL COMMENT

1. Section 3-203 is based on former Section 3-201 which stated that a transferee received such rights as the transferor had. The former section was confusing because some rights of the transferor are not vested in the transferee unless the transfer is a negotiation. For example, a transferee that did not become the holder could not negotiate the instrument, a right that the transferor had. Former Section 3-201 did not define "transfer." Subsection (a) defines transfer by limiting it to cases in which possession of the instrument is delivered for the purpose of giving to the person receiving delivery the right to enforce the instrument.

Although transfer of an instrument might mean in a particular case that title to the instrument passes to the transferee, that result does not follow in all cases. The right to enforce an instrument and ownership of the instrument are two different concepts. A thief who steals a check payable to bearer becomes the holder of the check and a person entitled to enforce it, but does not become the owner of the check. If the thief transfers the check to a purchaser the transferee obtains the right to enforce the check. If the purchaser is not a holder in due course, the owner's claim to the check may be asserted against the purchaser. Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3, which do not depend upon whether the instrument was transferred under Section 3-203. Moreover, a person who has an ownership right in an instrument might not be a person entitled to enforce the instrument. For example, suppose X is the owner and holder of an instrument payable to X. X sells the instrument to Y but is unable to deliver immediate possession to Y. Instead, X signs a document conveying all of X's right, title, and interest in the instrument to Y. Although the document may be effective to give Y a claim to ownership of the instrument, Y is not a person entitled to enforce the instrument until Y obtains possession of the instrument. No transfer of the instrument occurs under Section 3-203(a) until it is delivered to Y.

An instrument is a reified right to payment. The right is represented by the instrument itself. The right to payment is transferred by delivery of possession of the instrument "by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument." The quoted phrase excludes issue of an instrument, defined in Section 3-105, and cases in which a delivery of possession is for some purpose other than transfer of the right to enforce. For example, if a check is presented for payment by delivering the check to the

drawee, no transfer of the check to the drawee occurs because there is no intent to give the drawee the right to enforce the check.

2. Subsection (b) states that transfer vests in the transferee any right of the transferor to enforce the instrument "including any right as a holder in due course." If the transferee is not a holder because the transferor did not indorse, the transferee is nevertheless a person entitled to enforce the instrument under Section 3-301 if the transferor was a holder at the time of transfer. Although the transferee is not a holder, under subsection (b) the transferee obtained the rights of the transferor as holder. Because the transferee's rights are derivative of the transferor's rights, those rights must be proved. Because the transferee is not a holder, there is no presumption under Section 3-308 that the transferee, by producing the instrument, is entitled to payment. The instrument, by its terms, is not payable to the transferee and the transferee must account for possession of the unindorsed instrument by proving the transaction through which the transferee acquired it. Proof of a transfer to the transferee by a holder is proof that the transferee has acquired the rights of a holder. At that point the transferee is entitled to the presumption under Section 3-308.

Under subsection (b) a holder in due course that transfers an instrument transfers those rights as a holder in due course to the purchaser. The policy is to assure the holder in due course a free market for the instrument. There is one exception to this rule stated in the concluding clause of subsection (b). A person who is party to fraud or illegality affecting the instrument is not permitted to wash the instrument clean by passing it into the hands of a holder in due course and then repurchasing it.

3. Subsection (c) applies only to a transfer for value. It applies only if the instrument is payable to order or specially indorsed to the transferor. The transferee acquires, in the absence of a contrary agreement, the specifically enforceable right to the indorsement of the transferor. Unless otherwise agreed, it is a right to the general indorsement of the transferor with full liability as indorser, rather than to an indorsement without recourse. The question may arise if the transferee has paid in advance and the indorsement is omitted fraudulently or through oversight. A transferor who is willing to indorse only without recourse or unwilling to indorse at all should make those intentions clear before transfer. The agreement of the transferee to take less than an unqualified indorsement need not be an express one, and the understanding may be implied from conduct, from past practice, or from the circumstances of the transaction. Subsection (c) provides that there is no negotiation of the instrument until the indorsement by the transferor is made. Until that time the transferee does not become a holder, and if earlier notice of a defense or claim is received, the transferee does not qualify as a holder in due course under Section 3-302.

4. The operation of Section 3-203 is illustrated by the following cases. In each case Payee, by fraud, induced Maker to issue a note to Payee. The fraud is a defense to the obligation of Maker to pay the note under Section 3-305(a)(2).

Case #1. Payee negotiated the note to X who took as a holder in due course. After the instrument became overdue X negotiated the note to Y who had notice of the fraud. Y succeeds to X's rights as a holder in due course and takes free of Maker's defense of fraud.

Case #2. Payee negotiated the note to X who took as a holder in due course. Payee then repurchased the note from X. Payee does not succeed to X's rights as a holder in due course and is subject to Maker's defense of fraud.

Case #3. Payee negotiated the note to X who took as a holder in due course. X sold the note to Purchaser who received possession. The note, however, was indorsed to X and X failed to indorse it. Purchaser is a person entitled to enforce the instrument under Section 3-301 and succeeds to the rights of X as holder in due course. Purchaser is not a holder, however, and under Section 3-308 Purchaser will have to prove the transaction with X under which the rights of X as holder in due course were acquired.

Case #4. Payee sold the note to Purchaser who took for value, in good faith and without notice of the defense of Maker. Purchaser received possession of the note but Payee neglected to indorse it. Purchaser became a person entitled to enforce the instrument but did not become the holder because of the missing indorsement. If Purchaser received notice of the defense of Maker before obtaining the indorsement of Payee, Purchaser cannot become a holder in due course because at the time notice was received the note had not been negotiated to Purchaser. If indorsement by Payee was made after Purchaser received notice, Purchaser had notice of the defense when it became the holder.

5. Subsection (d) restates former Section 3-202(3). The cause of action on an instrument cannot be split. Any indorsement which purports to convey to any party less than the entire amount of the instrument is not effective for negotiation. This is true of either "Pay A one-half," or "Pay A two-thirds and B one-third." Neither A nor B becomes a holder. On the other hand an indorsement reading merely "Pay A and B" is effective, since it transfers the entire cause of action to A and B as tenants in common. An indorsement purporting to convey less than the entire instrument does, however, operate as a partial assignment of the cause of action. Subsection (d) makes no attempt to state the legal effect of such an assignment, which is left to

other law. A partial assignee of an instrument has rights only to the extent the applicable law gives rights, either at law or in equity, to a partial assignee.

ANNOTATION

I. GENERAL CONSIDERATION.

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Applied in Blake v. Samuelson, 34 Colo. App. 183, 524 P.2d 624 (1974); West Greeley Nat'l Bank v. Wygant, 650 P.2d 1339 (Colo. App. 1982); Hollemon v. Murray, 666 P.2d 1107 (Colo. App. 1982).

II. TRANSFER.

Transfer without indorsement vests same title as transferor. When no right of a creditor is involved, an instrument like a note may be transferred as a donation or for value by delivery without indorsement so as to vest in the transferee such title as the transferor had at least. Lane v. Lane, 57 Colo. 419, 140 P. 804 (1914). See Gumaer v. Sowers, 31 Colo. 164, 71 P. 1103 (1903); Bank of Bromfield v. McKinlay, 53 Colo. 279, 125 P. 493 (1912).

An indorsement by the payee is not a prerequisite to recovery by an assignee of a note, for if the transferor had a valid claim to the notes, the transferee would assume the same rights even though no formal indorsement by the transferor has taken place. Denver-Metro Collections, Inc. v. Kleeman, 30 Colo. App. 218, 491 P.2d 64 (1971); Pay Center, Inc. v. Milton, 632 P.2d 642 (Colo. App. 1981).

A transferee of a note may bring an action on the note even though unindorsed provided the note is delivered and he proves assignment of the note. Denver-Metro Collections, Inc. v. Kleeman, 30 Colo. App. 218, 491 P.2d 64 (1971).

Assignment of guaranty. A guaranty that does not expressly forbid assignment is assignable without the guarantor's express consent. Republic Nat'l Bank v. Meridian Props., Inc., 530 F. Supp. 169 (D. Colo. 1982).

Although delivery is not made until trial date. An assignee can maintain its suit although the unindorsed notes are not delivered until the date of trial, as it would be elevating form over substance to require a new trial merely because the payee failed to deliver the notes before trial where he had assigned them to the assignee before such date. Denver-Metro Collections, Inc. v. Kleeman, 30 Colo. App. 218, 491 P.2d 64 (1971).

Uncontradicted testimony of oral assignment suffices. Where the payee specifically testifies that he had made an oral assignment to the assignee and no evidence is offered to contradict this testimony, such testimony is sufficient to support the trial court's finding that an assignment had been made to the assignee. Denver-Metro Collections, Inc. v. Kleeman, 30 Colo. App. 218, 491 P.2d 64 (1971).

Where a note is assigned by the payee after maturity and is thus shorn of immunity from all defenses which might have been urged against it before assignment, or notice thereof, by the maker while yet in the hands of the payee while it still retained its negotiable character, it is subject to any defense which would have been available had it been nothing more than a simple contract or chose in action, transferred by assignment First Nat'l Bank v. Lewis, 57 Colo. 124, 139 P. 1102 (1914).

Transferee's rights on note. A transferee retains the right to sue on a note but is not aided by any presumption that he is entitled to recover and he takes the notes subject to all defenses and equities to which the notes were subject in the hands of the transferor. Pay Center, Inc. v. Milton, 632 P.2d 642 (Colo. App. 1981).

4-3-204. Indorsement. (a) "Indorsement" means a signature, other than that of a signer as maker, drawer, or acceptor, that alone or accompanied by other words is made on an instrument for the purpose of (i) negotiating the instrument, (ii) restricting payment of the instrument, or (iii) incurring indorser's liability on the instrument, but regardless of the intent of the signer, a signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement. For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument.

(b) "Indorser" means a person who makes an indorsement.

(c) For the purpose of determining whether the transferee of an instrument is a holder, an indorsement that transfers a security interest in the instrument is effective as an unqualified indorsement of the instrument.

(d) If an instrument is payable to a holder under a name that is not the name of the

holder, indorsement may be made by the holder in the name stated in the instrument or in the holder's name or both, but signature in both names may be required by a person paying or taking the instrument for value or collection.

Source: L. 94: Entire article R&RE, p. 851, § 1, effective January 1, 1995.

Editor's note: This section is similar to former §§ 4-3-201, 4-3-202, and 4-3-203 as they existed prior to 1994.

OFFICIAL COMMENT

1. Subsection (a) is a definition of "indorsement," a term which was not defined in former Article 3. Indorsement is defined in terms of the purpose of the signature. If a blank or special indorsement is made to give rights as a holder to a transferee the indorsement is made for the purpose of negotiating the instrument. Subsection (a)(i). If the holder of a check has an account in the drawee bank and wants to be sure that payment of the check will be made by credit to the holder's account, the holder can indorse the check by signing the holder's name with the accompanying words "for deposit only" before presenting the check for payment to the drawee bank. In that case the purpose of the quoted words is to restrict payment of the instrument. Subsection (a)(ii). If X wants to guarantee payment of a note signed by Y as maker, X can do so by signing X's name to the back of the note as an indorsement. This indorsement is known as an anomalous indorsement (Section 3-205(d)) and is made for the purpose of incurring indorser's liability on the note. Subsection (a)(iii). In some cases an indorsement may serve more than one purpose. For example, if the holder of a check deposits it to the holder's account in a depositary bank for collection and indorses the check by signing the holder's name with the accompanying words "for deposit only" the purpose of the indorsement is both to negotiate the check to the depositary bank and to restrict payment of the check.

The "but" clause of the first sentence of subsection (a) elaborates on former Section 3-402. In some cases it may not be clear whether a signature was meant to be that of an indorser, a party to the instrument in some other capacity such as drawer, maker or acceptor, or a person who was not signing as a party. The general rule is that a signature is an indorsement if the instrument does not indicate an unambiguous intent of the signer not to sign as an indorser. Intent may be determined by words accompanying the signature, the place of signature, or other circumstances. For example, suppose a depositary bank gives cash for a check properly indorsed by the payee. The bank requires the payee's employee to sign the back of the check as evidence that the employee received the cash. If the signature consists only of the initials of the employee it is not reasonable to assume that it was meant to be an indorsement. If there was a full signature but accompanying words indicated that it was meant as a receipt for the cash given for the check, it is not an indorsement. If the signature is not qualified in any way and appears in the place normally used for indorsements, it may be an indorsement even though the signer intended the signature to be a receipt. To take another example, suppose the drawee of a draft signs the draft on the back in the space usually used for indorsements. No words accompany the signature. Since the drawee has no reason to sign a draft unless the intent is to accept the draft, the signature is effective as an acceptance. Custom and usage may be used to determine intent. For example, by long-established custom and usage, a signature in the lower right hand corner of an instrument indicates an intent to sign as the maker of a note or the drawer of a draft. Any similar clear indication of an intent to sign in some other capacity or for some other purpose may establish that a signature is not an indorsement. For example, if the owner of a traveler's check countersigns the check in the process of negotiating it, the countersignature is not an indorsement. The countersignature is a condition to the issuer's obligation to pay and its purpose is to provide a means of verifying the identify of the person negotiating the traveler's check by allowing comparison of the specimen signature and the countersignature. The countersignature is not necessary for negotiation and the signer does not incur indorser's liability. See Comment 2 to Section 3-106.

The last sentence of subsection (a) is based on subsection (2) of former Section 3-202. An indorsement on an allonge is valid even though there is sufficient space on the instrument for an indorsement.

2. Assume that Payee indorses a note to Creditor as security for a debt. Under subsection (b) of Section 3-203 Creditor takes Payee's rights to enforce or transfer the instrument subject to the limitations imposed by Article 9. Subsection (c) of Section 3-204 makes clear that Payee's indorsement to Creditor, even though it mentions creation of a security interest, is an unqualified indorsement that gives to Creditor the right to enforce the note as its holder.

3. Subsection (d) is a restatement of former Section 3-203. Section 3-110(a) states that an instrument is payable to the person intended by the person signing as or in the name or behalf of the issuer even if that person is identified by a name that is not the true name of the person. In some cases the name used in the instrument is a misspelling of the correct name and in some cases the two names may be entirely different. The payee may indorse in the name used in the instrument, in the payee's correct name, or in both. In each case the indorsement is effective. But because an indorsement in a name different from that used in the instrument may raise a question about its validity and an indorsement in a name that is not the correct name of the payee may raise a problem of identifying the indorser, the accepted commercial practice is to indorse in both names. Subsection (d) allows a person paying or taking the instrument for value or collection to require indorsement in both names.

ANNOTATION

Law reviews. For article, "One Year Review of Contracts", see 36 Dicta 19 (1959).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Under the negotiable instruments law an indorsement must have been written on the instrument or upon a paper attached thereto, and the signature of the indorser without additional words was a sufficient indorsement. Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954).

Stapling indorsement to negotiable instrument is permanent attachment to checks so that it becomes "a part thereof". Lamson v. Commercial Credit Corp., 187 Colo. 382, 531 P.2d 966 (1975).

It is not the written name of the payee on the note, but his "signature" which constitutes an indorsement. Marks v. Munson, 59 Colo. 440, 149 P. 440 (1915).

In an action on a note where an indorsement is denied by the answer, the mere production of the note by the plaintiff is insufficient; rather both the execution and indorsement must be proved. Marks v. Munson, 59 Colo. 440, 149 P. 440 (1915); Myrick v. Garcia, 138 Colo. 298, 332 P.2d 900 (1958).

Production of a note by the plaintiff is a prima facie title under a general denial. In an action on a promissory note by the indorsee, possession and production of the note by the plaintiff with an indorsement of the payee's name is prima facie evidence of title in the plaintiff where the title is at issue under a general denial. Gumaer v. Sowers, 31 Colo. 164, 71 P. 1103 (1903).

Indorsement must be written on behalf of holder. La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

The term "indorsement" is generally understood to mean the indorser's writing of his or her signature on the instrument or some designation identifying the indorsement on the instrument. A check simply inscribed "For deposit only" to an account other than the payee's account and without the payee's signature is not an effective "indorsement." Kelly v. Central Bank and Trust Co., 794 P.2d 1037 (Colo. App. 1989).

A negotiable instrument may be indorsed by an authorized representative on behalf of the holder. First Nat. Bank v. Lohman, 827 P.2d 583 (Colo. App. 1992).

Former § 4-3-202 applied in Barclay Receivables v. Mountain Majesty, Ltd., 903 P.2d 37 (Colo. App. 1995).

Where joint payees fail to indorse a check and a bank accepts such for deposit to the credit of one indorsing payee only, the negotiability of the check is destroyed, and subsequent holders are not holders in due course, but rather the relation of all parties thereafter is governed by rules of assignment. Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954) (decided under repealed CSA, C. 112, § 32, negotiable instruments law).

Transferee for value, whether under transaction denoted an "assignment" or otherwise, was entitled to unqualified indorsement by the payee of the instrument transferred in absence of agreement to the contrary. Pierce v. DeZeeuw, 824 P.2d 97 (Colo. App. 1991).

Transferee for value, whether under transaction denoted an "assignment" or otherwise, was entitled to unqualified indorsement by the payee of the instrument transferred in absence of agreement to the contrary. Pierce v. DeZeeuw, 824 P.2d 97 (Colo. App. 1991).

A negotiable instrument may be indorsed by an authorized representative on behalf of the holder. First Nat. Bank v. Lohman, 827 P.2d 583 (Colo. App. 1992).

In an action on a note where an indorsement is denied by the answer, the mere production of the note by a party is insufficient; both the execution and indorsement must be proved. Marks v. Munson, 59 Colo. 440 (1915); Myrick v. Garcia, 138 Colo. 298, 332 P.2d 900 (1958).

Indorsement "Demand, notice and protest waived. Payment guaranteed" held to be a surety or accommodation party. See Winton v. Sullivan, 104 Colo. 450, 91 P.2d 996 (1939).

4-3-205. Special indorsement; blank indorsement; anomalous indorsement. (a) If an indorsement is made by the holder of an instrument, whether payable to an identified person or payable to bearer, and the indorsement identifies a person to whom it makes the instrument payable, it is a "special indorsement." When specially indorsed, an instrument becomes payable to the identified person and may be negotiated only by the indorsement of that person. The principles stated in section 4-3-110 apply to special indorsements.

(b) If an indorsement is made by the holder of an instrument and it is not a special indorsement, it is a "blank indorsement." When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of possession alone until specially indorsed.

(c) The holder may convert a blank indorsement that consists only of a signature into a special indorsement by writing, above the signature of the indorser, words identifying the person to whom the instrument is made payable.

(d) "Anomalous indorsement" means an indorsement made by a person who is not the holder of the instrument. An anomalous indorsement does not affect the manner in which the instrument may be negotiated.

Source: L. 94: Entire article R&RE, p. 851, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-204 as it existed prior to 1994.

OFFICIAL COMMENT

1. Subsection (a) is based on subsection (1) of former Section 3-204. It states the test of a special indorsement to be whether the indorsement identifies a person to whom the instrument is payable. Section 3-110 states rules for identifying the payee of an instrument. Section 3-205(a) incorporates the principles stated in Section 3-110 in identifying an indorsee. The language of Section 3-110 refers to language used by the issuer of the instrument. When that section is used with respect to an indorsement, Section 3-110 must be read as referring to the language used by the indorser.

2. Subsection (b) is based on subsection (2) of former Section 3-204. An indorsement made by the holder is either a special or blank indorsement. If the indorsement is made by a holder and is not a special indorsement, it is a blank indorsement. For example, the holder of an instrument, intending to make a special indorsement, writes the words "Pay to the order of" without completing the indorsement by writing the name of the indorsee. The holder's signature appears under the quoted words. The indorsement is not a special indorsement because it does not identify a person to whom it makes the instrument payable. Since it is not a special indorsement it is a blank indorsement and the instrument is payable to bearer. The result is analogous to that of a check in which the name of the payee is left blank by the drawer. In that case the check is payable to bearer. See the last paragraphs of Comment 2 to Section 3-115.

A blank indorsement is usually the signature of the indorser on the back of the instrument without other words. Subsection (c) is based on subsection (3) of former Section 3-204. A "restrictive indorsement" described in Section 3-206 can be either a blank indorsement or a special indorsement. "Pay to T, in trust for B" is a restrictive indorsement. It is also a special indorsement because it identifies T as the person to whom the instrument is payable. "For deposit only" followed by the signature of the payee of a check is a restrictive indorsement. It is also a blank indorsement because it does not identify the person to whom the instrument is payable.

3. The only effect of an "anomalous indorsement," defined in subsection (d), is to make the signer liable on the instrument as an indorser. Such an indorsement is normally made by an accommodation party. Section 3-419.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Where an agent who receives checks is authorized to indorse them in blank and deposit them to his principal's credit in the principal's bank and the bank has no knowledge of limitation upon the authority of the agent to indorse the checks only when deposited for the principal's credit, and the agent indorses and cashes a number of these checks for his own use appropriating the money, which checks the bank also pays, the bank is not liable to the principal for the checks thus appropriated by his agent. And that the fact that such checks are indorsed by other persons in blank following the indorse-

ment by the agent for the principal while the checks deposited in bank to the principal's credit are indorsed only by the agent would not charge the bank with notice of the limitation upon the agent's authority. Wedge Mines Co. v. Denver Nat'l Bank, 19 Colo. App. 182, 73 P. 873 (1903).

The legal effect of a blank indorsement on a promissory note cannot be varied by parol evidence, and all testimony in regard to a parol agreement between the indorser and indorsee contemporaneous with such indorsement is incompetent. Torbert v. Montague, 38 Colo. 325, 87 P. 1145 (1906).

Addition by holder of the words "deposit only" to indorser's blank indorsement neither changed blank indorsement into a special indorsement, nor altered the effect of the blank indorsement, but was in fact a restrictive indorsement by holder which imposed a duty upon depository bank to honor holder's restrictive indorsement. La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

4-3-206. Restrictive indorsement. (a) An indorsement limiting payment to a particular person or otherwise prohibiting further transfer or negotiation of the instrument is not effective to prevent further transfer or negotiation of the instrument.

(b) An indorsement stating a condition to the right of the indorsee to receive payment does not affect the right of the indorsee to enforce the instrument. A person paying the instrument or taking it for value or collection may disregard the condition, and the rights and liabilities of that person are not affected by whether the condition has been fulfilled.

(c) If an instrument bears an indorsement (i) described in section 4-4-201 (b), or (ii) in blank or to a particular bank using the words "for deposit," "for collection," or other words indicating a purpose of having the instrument collected by a bank for the indorser or for a particular account, the following rules apply:

(1) A person, other than a bank, who purchases the instrument when so indorsed converts the instrument unless the amount paid for the instrument is received by the indorser or applied consistently with the indorsement.

(2) A depositary bank that purchases the instrument or takes it for collection when so indorsed converts the instrument unless the amount paid by the bank with respect to the instrument is received by the indorser or applied consistently with the indorsement.

(3) A payor bank that is also the depositary bank or that takes the instrument for immediate payment over the counter from a person other than a collecting bank converts the instrument unless the proceeds of the instrument are received by the indorser or applied consistently with the indorsement.

(4) Except as otherwise provided in paragraph (3) of this subsection (c), a payor bank or intermediary bank may disregard the indorsement and is not liable if the proceeds of the instrument are not received by the indorser or applied consistently with the indorsement.

(d) Except for an indorsement covered by subsection (c) of this section, if an instrument bears an indorsement using words to the effect that payment is to be made to the indorsee as agent, trustee, or other fiduciary for the benefit of the indorser or another person, the following rules apply:

(1) Unless there is notice of breach of fiduciary duty as provided in section 4-3-307, a person who purchases the instrument from the indorsee or takes the instrument from the indorsee for collection or payment may pay the proceeds of payment or the value given for the instrument to the indorsee without regard to whether the indorsee violates a fiduciary duty to the indorser.

(2) A subsequent transferee of the instrument or person who pays the instrument is neither given notice nor otherwise affected by the restriction in the indorsement unless the transferee or payor knows that the fiduciary dealt with the instrument or its proceeds in breach of fiduciary duty.

(e) The presence on an instrument of an indorsement to which this section applies does not prevent a purchaser of the instrument from becoming a holder in due course of the instrument unless the purchaser is a converter under subsection (c) of this section or has notice or knowledge of breach of fiduciary duty as stated in subsection (d) of this section.

(f) In an action to enforce the obligation of a party to pay the instrument, the obligor has a defense if payment would violate an indorsement to which this section applies and the payment is not permitted by this section.

Source: L. 94: Entire article R&RE, p. 852, § 1, effective January 1, 1995.

Editor's note: This section is similar to former §§ 4-3-205 and 4-3-206 as they existed prior to 1994.

OFFICIAL COMMENT

1. This section replaces former Sections 3-205 and 3-206 and clarifies the law of restrictive indorsements.

2. Subsection (a) provides that an indorsement that purports to limit further transfer or negotiation is ineffective to prevent further transfer or negotiation. If a payee indorses "Pay A only," A may negotiate the instrument to subsequent holders who may ignore the restriction on the indorsement. Subsection (b) provides that an indorsement that states a condition to the right of a holder to receive payment is ineffective to condition payment. Thus if a payee indorses "Pay A if A ships goods complying with our contract," the right of A to enforce the instrument is not affected by the condition. In the case of a note, the obligation of the maker to pay A is not affected by the indorsement. In the case of a check, the drawee can pay A without regard to the condition, and if the check is dishonored the drawer is liable to pay A. If the check was negotiated by the payee to A in return for a promise to perform a contract and the promise was not kept, the payee would have a defense or counterclaim against A if the check were dishonored and A sued the payee as indorser, but the payee would have that defense or counterclaim whether or not the condition to the right of A was expressed in the indorsement. Former Section 3-206 treated a conditional indorsement like indorsements for deposit or collection. In revised Article 3, Section 3-206(b) rejects that approach and makes the conditional indorsement ineffective with respect to parties other than the indorser and indorsee. Since the indorsements referred to in subsections (a) and (b) are not effective as restrictive indorsements, they are no longer described as restrictive indorsements.

3. The great majority of restrictive indorsements are those that fall within subsection (c) which continues previous law. The depositary bank or the payor bank, if it takes the check for immediate payment over the counter, must act consistently with the indorsement, but an intermediary bank or payor bank that takes the check from a collecting bank is not affected by the indorsement. Any other person is also bound by the indorsement. For example, suppose a check is payable to X, who indorses in blank but writes above the signature the words "For deposit only." The check is stolen and is cashed at a grocery store by the thief. The grocery store indorses the check and deposits it in Depositary Bank. The account of the grocery store is credited and the check is forwarded to Payor Bank which pays the check. Under subsection (c), the grocery store and Depositary Bank are converters of the check because X did not receive the amount paid for the check. Payor Bank and any intermediary bank in the collection process are not liable to X. This Article does not displace the law of waiver as it may apply to restrictive indorsements. The circumstances under which a restrictive indorsement may be waived by the person who made it is not determined by this Article.

4. Subsection (d) replaces subsection (4) of former Section 3-206. Suppose Payee indorses a check "Pay to T in trust for B." T indorses in blank and delivers it to (a) Holder for value; (b) Depositary Bank for collection; or (c) Payor Bank for payment. In each case these takers can safely pay T so long as they have no notice under Section 3-307 of any breach of fiduciary duty that T may be committing. For example, under subsection (b) of Section 3-307 these takers have notice of a breach of trust if the check was taken in any transaction known by the taker to be for T's personal benefit. Subsequent transferees of the check from Holder or Depositary Bank are not affected by the restriction unless they have knowledge that T dealt with the check in breach of trust.

5. Subsection (f) allows a restrictive indorsement to be used as a defense by a person obliged to pay the instrument if that person would be liable for paying in violation of the indorsement.

ANNOTATION

I. GENERAL CONSIDERATION.

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Because of statute. Unrestricted indorsements cannot be varied either by parol evidence or evidence of custom in business for the reason that the statute definitely defines their meaning and controls their effect. Interstate Trust Co. v. United States Nat'l Bank, 67 Colo. 6, 185 P. 260 (1919).

An unrestricted indorsement cannot be varied or changed by parol evidence. Shaw v. Brady, 80 Colo. 337, 251 P. 532 (1926).

Or evidence of custom. Interstate Trust Co. v. United States Nat'l Bank, 67 Colo. 6, 185 P. 260 (1919).

Latter special indorsement superseded restrictive indorsement. Where a depository bank specially indorsed a check to the plaintiff, who became a holder in his own right, payment by the maker to the plaintiff was not contrary to a restrictive indorsement "pay any bank", because the latter special indorsement superseded the restrictive indorsement and such action by the depository bank was the equivalent of a constructive cancellation. Thus, any satisfaction to the ensuing holder was not inconsistent with the terms of the previous restrictive indorsement. Lamson v. Commercial Credit Corp., 187 Colo. 382, 531 P.2d 966 (1975).

Addition by holder of the words "deposit only" to indorser's blank indorsement neither changed blank indorsement into a special indorsement, nor altered the effect of the blank indorsement, but was in fact a restrictive indorsement by holder which imposed a duty on depository bank to honor holder's restrictive indorsement. La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

Indorsement directing payment "to any bank — previous indorsements guaranteed" considered not restrictive. Interstate Trust Co. v. United States Nat'l Bank, 67 Colo. 6, 185 P. 260 (1919).

Addition by holder of the words "deposit only" to indorser's blank indorsement neither changed blank indorsement into a special indorsement, nor altered the effect of the blank indorsement, but was in fact a restrictive indorsement by holder which imposed a duty on depository bank to honor holder's restrictive indorsement. La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

Indorsement "for deposit" was restrictive and imposed duty upon depository bank to not deposit funds in any account other than the indorser's account. Travis v. La Junta State Bank, 694 P.2d 350 (Colo. App. 1984).

This section defines a "trust" restrictive indorsement. Walter E. Heller & Co. v. Mesa Bldg. Prods. Co., 233 F. Supp. 434 (D. Colo. 1964).

II. NEGOTIATION NOT PREVENTED.

Under N.I.L. legal title vested with a restrictive indorsement. Walter E. Heller & Co. v. Mesa Bldg. Prods. Co., 233 F. Supp. 434 (D. Colo. 1964) (indorsee); Barnes v. Cherry Creek Nat'l Bank, 163 Colo. 414, 431 P.2d 471 (1967) (indorser).

But under UCC negotiability is not destroyed by mere addition of a restrictive indorsement. La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

Negotiability was destroyed. Barnes v. Cherry Creek Nat'l Bank, 163 Colo. 414, 431 P.2d 471 (1967).

With bank receiving such in deposit becoming an agent for collection. Barnes v. Cherry Creek Nat'l Bank, 163 Colo. 414, 431 P.2d 471 (1967).

Liable for paying impostor. Barnes v. Cherry Creek Nat'l Bank, 163 Colo. 414, 431 P.2d 471 (1967).

III. INTERMEDIARY OR PAYOR BANK.

Subsection (2) under former law not in conflict with requirements of § 4-4-205 (2) under former law. The clear import of both subsection (2) and § 4-4-205 (2) is that, while intermediary banks and nondepository payor banks may ignore all restrictive indorsements except those of the bank's immediate transferor, depository banks may not so ignore restrictive indorsements. La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

4-3-207. Reacquisition. Reacquisition of an instrument occurs if it is transferred to a former holder, by negotiation or otherwise. A former holder who reacquires the instrument may cancel indorsements made after the reacquirer first became a holder of the instrument. If the cancellation causes the instrument to be payable to the reacquirer or to bearer, the reacquirer may negotiate the instrument. An indorser whose indorsement is canceled is discharged, and the discharge is effective against any subsequent holder.

Source: L. 94: Entire article R&RE, p. 853, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-208 as it existed prior to 1994.

Cross references: For the effect of discharge against a holder in due course, see § 4-3-601; for payment or satisfaction, see § 4-3-602; for cancellation and renunciation, see § 4-3-604.

OFFICIAL COMMENT

Section 3-207 restates former Section 3-208. Reacquisition refers to cases in which a former holder reacquires the instrument either by negotiation from the present holder or by a transfer other than negotiation. If the reacquisition is by negotiation, the former holder reacquires the status of holder. Although Section 3-207 allows the holder to cancel all indorsements made after the holder first acquired holder status, cancellation is not necessary. Status of holder is not affected whether or not cancellation is made. But if the reacquisition is not the result of negotiation the former holder can obtain holder status only by striking the former holder's indorsement and any subsequent indorsements. The latter case is an exception to the general rule that if an instrument is payable to an identified person, the indorsement of that person is necessary to allow a subsequent transferee to obtain the status of holder. Reacquisition without indorsement by the person to whom the instrument is payable is illustrated by two examples:

Case #1. X, a former holder, buys the instrument from Y, the present holder. Y delivers the instrument to X but fails to indorse it. Negotiation does not occur because the transfer of possession did not result in X's becoming holder. Section 3-201(a). The instrument by its terms is payable to Y, not to X. But X can obtain the status of holder by striking X's indorsement and all subsequent indorsements. When these indorsements are struck, the instrument by its terms is payable either to X or to bearer, depending upon how X originally became holder. In either case X becomes holder. Section 1-201(20).

Case #2. X, the holder of an instrument payable to X, negotiates it to Y by special indorsement. The negotiation is part of an underlying transaction between X and Y. The underlying transaction is rescinded by agreement of X and Y, and Y returns the instrument without Y's indorsement. The analysis is the same as that in Case #1. X can obtain holder status by canceling X's indorsement to Y.

In Case #1 and Case #2, X acquired ownership of the instrument after reacquisition, but X's title was clouded because the instrument by its terms was not payable to X. Normally, X can remedy the problem by obtaining Y's indorsement, but in some cases X may not be able to conveniently obtain that indorsement. Section 3-207 is a rule of convenience which relieves X of the burden of obtaining an indorsement that serves no substantive purpose. The effect of cancellation of any indorsement under Section 3-207 is to nullify it. Thus, the person whose indorsement is canceled is relieved of indorser's liability. Since cancellation is notice of discharge, discharge is effective even with respect to the rights of a holder in due course. Sections 3-601 and 3-604.

ANNOTATION

Holder of a note indorsed in blank may strike out all indorsements subsequent to that of the payee and hold directly from him. Marks v. Munson, 59 Colo. 440, 149 P. 440 (1915) (decided under repealed laws antecedent to CSA, C. 112, § 48, negotiable instruments law).

PART 3

ENFORCEMENT OF INSTRUMENTS

4-3-301. Person entitled to enforce instrument. "Person entitled to enforce" an instrument means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to section 4-3-309 or 4-3-418 (d). A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.

Source: L. 94: Entire article R&RE, p. 853, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-301 as it existed prior to 1994.

OFFICIAL COMMENT

This section replaces former Section 3-301 that stated the rights of a holder. The rights stated in former Section 3-301 to transfer, negotiate, enforce, or discharge an instrument are stated in other sections of Article 3. In revised Article 3, Section 3-301 defines "person entitled to enforce" an instrument. The definition recognizes that enforcement is not limited to holders. The quoted phrase includes a person enforcing a lost or stolen instrument. Section 3-309. It also includes a person in possession of an instrument who is not a holder. A nonholder in possession of an instrument includes a person that acquired rights of a holder by subrogation or under Section 3-203(a). It also includes any other person who under applicable law is a successor to the holder or otherwise acquires the holder's rights.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

A note drawn to alternative, not joint, payees can be discharged only by a holder of the instrument. Reese v. Lietzan, 160 Colo. 253, 419 P.2d 959 (1966).

A holder of a note may sue upon it even if held as collateral to another which is unpaid. Rogers v. First State Bank, 79 Colo. 84, 243 P. 637 (1926); Smith v. Weindrop, 833 P.2d 856 (Colo. App. 1992).

If holder does not have entire interest. A holder may bring suit on a promissory note even if he does not have the entire interest in it. Retallic v. Dickson, 75 Colo. 123, 224 P. 1054 (1924).

If holder paid nothing. The indorsee of a promissory note is entitled to an action thereon against the maker though he paid nothing for it as well as against a prior indorser. Sykes v. Kruse, 49 Colo. 560, 113 P. 1013 (1914).

Payee, not the owner, cannot by suit cut off defense which maker might have against real party in interest. Retallic v. Dickson, 75 Colo. 123, 224 P. 1054 (1924).

No judgment can be legally rendered against the makers of a promissory note in favor of the original payee who has parted with his title thereto before the bringing of the action where there is nothing to show there had been a redelivery to him before the beginning of the action or at the time of the trial. Shaw v. Brady, 80 Colo. 337, 251 P. 532 (1926).

Plaintiff's possession of a promissory note is prima facie evidence of ownership although indorsed by him as against a general objection that his complaint does not state any cause of action. Gumaer v. Jackson, 37 Colo. 39, 86 P. 885 (1906).

The holder of a promissory note may set off the amount thereof in an action by the maker against him, even though he purchased the note solely for the purpose of so applying it and regardless of the fact that he acquired the note at a great discount. Holick v. Stokes, 53 Colo. 385, 127 P. 143 (1912).

Applied in Commercial Credit Corp. v. Univ. Nat'l Bank, 590 F.2d 849 (10th Cir. 1979); La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

4-3-302. Holder in due course. (a) Subject to subsection (c) of this section and section 4-3-106 (d) "holder in due course" means the holder of an instrument if:

(1) The instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and

(2) The holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in section 4-3-306, and (vi) without notice that any party has a defense or claim in recoupment described in section 4-3-305 (a).

(b) Notice of discharge of a party, other than discharge in an insolvency proceeding, is not notice of a defense under subsection (a) of this section, but discharge is effective against a person who became a holder in due course with notice of the discharge. Public filing or recording of a document does not of itself constitute notice of a defense, claim in recoupment, or claim to the instrument.

(c) Except to the extent a transferor or predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar

proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

(d) If, under section 4-3-303 (a) (1), the promise of performance that is the consideration for an instrument has been partially performed, the holder may assert rights as a holder in due course of the instrument only to the fraction of the amount payable under the instrument equal to the value of the partial performance divided by the value of the promised performance.

(e) If (i) the person entitled to enforce an instrument has only a security interest in the instrument and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

(f) To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it.

(g) This section is subject to any law limiting status as a holder in due course in particular classes of transactions.

Source: L. 94: Entire article R&RE, p. 853, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-302 as it existed prior to 1994.

Cross references: For the effect of the "Uniform Consumer Credit Code" on holder in due course, see § 5-3-303.

OFFICIAL COMMENT

1. Subsection (a)(1) is a return to the N.I.L. rule that the taker of an irregular or incomplete instrument is not a person the law should protect against defenses of the obligor or claims of prior owners. This reflects a policy choice against extending the holder in due course doctrine to an instrument that is so incomplete or irregular "as to call into question its authenticity." The term "authenticity" is used to make it clear that the irregularity or incompleteness must indicate that the instrument may not be what it purports to be. Persons who purchase or pay such instruments should do so at their own risk. Under subsection (1) of former Section 3-304, irregularity or incompleteness gave a purchaser notice of a claim or defense. But it was not clear from that provision whether the claim or defense had to be related to the irregularity or incomplete aspect of the instrument. This ambiguity is not present in subsection (a)(1).

2. Subsection (a)(2) restates subsection (1) of former Section 3-302. Section 3-305(a) makes a distinction between defenses to the obligation to pay an instrument and claims in recoupment by the maker or drawer that may be asserted to reduce the amount payable on the instrument. Because of this distinction, which was not made in former Article 3, the reference in subsection (a)(2)(vi) is to both a defense and a claim in recoupment. Notice of forgery or alteration is stated separately because forgery and alteration are not technically defenses under subsection (a) of Section 3-305.

3. Discharge is also separately treated in the first sentence of subsection (b). Except for discharge in an insolvency proceeding, which is specifically stated to be a real defense in Section 3-305(a)(1), discharge is not expressed in Article 3 as a defense and is not included in Section 3-305(a)(2). Discharge is effective against anybody except a person having rights of a holder in due course who took the instrument without notice of the discharge. Notice of discharge does not disqualify a person from becoming a holder in due course. For example, a check certified after it is negotiated by the payee may subsequently be negotiated to a holder. If the holder had notice that the certification occurred after negotiation by the payee, the holder necessarily had notice of the discharge of the payee as indorser. Section 3-415(d). Notice of that discharge does not prevent the holder from becoming a holder in due course, but the discharge is effective against the holder. Section 3-601(b). Notice of a defense under Section 3-305(a)(1) of a maker, drawer or acceptor based on a bankruptcy discharge is different. There is no reason to give holder in due course status to a person with notice of that defense. The second sentence of subsection (b) is from former Section 3-304(5).

4. Professor Britton in his treatise Bills and Notes 309 (1961) stated: "A substantial number of decisions before the [N.I.L.] indicates that at common law there was nothing in the position

of the payee as such which made it impossible for him to be a holder in due course." The courts were divided, however, about whether the payee of an instrument could be a holder in due course under the N.I.L.. Some courts read N.I.L. § 52(4) to mean that a person could be a holder in due course only if the instrument was "negotiated" to that person. N.I.L. § 30 stated that "an instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof." Normally, an instrument is "issued" to the payee; it is not transferred to the payee. N.I.L. § 191 defined "issue" as the "first delivery of the instrument * * * to a person who takes it as a holder." Thus, some courts concluded that the payee never could be a holder in due course. Other courts concluded that there was no evidence that the N.I.L. was intended to change the common law rule that the payee could be a holder in due course. Professor Britton states on p.318: "The typical situations which raise the [issue] are those where the defense of a maker is interposed because of fraud by a [maker who is] principal debtor * * * against a surety co-maker, or where the defense of fraud by a purchasing remitter is interposed by the drawer of the instrument against the good faith purchasing payee."

Former Section 3-302(2) stated: "A payee may be a holder in due course." This provision was intended to resolve the split of authority under the N.I.L. It made clear that there was no intent to change the common-law rule that allowed a payee to become a holder in due course. See Comment 2 to former Section 3-302. But there was no need to put subsection (2) in former Section 3-302 because the split in authority under the N.I.L. was caused by the particular wording of N.I.L. § 52(4). The troublesome language in that section was not repeated in former Article 3 nor is it repeated in revised Article 3. Former Section 3-302(2) has been omitted in revised Article 3 because it is surplusage and may be misleading. The payee of an instrument can be a holder in due course, but use of the holder-in-due-course doctrine by the payee of an instrument is not the normal situation.

The primary importance of the concept of holder in due course is with respect to assertion of defenses or claims in recoupment (Section 3-305) and of claims to the instrument (Section 3-306). The holder-in-due-course doctrine assumes the following case as typical. Obligor issues a note or check to Obligee. Obligor is the maker of the note or drawer of the check. Obligee is the payee. Obligor has some defense to Obligor's obligation to pay the instrument. For example, Obligor issued the instrument for goods that Obligee promised to deliver. Obligee never delivered the goods. The failure of Obligee to deliver the goods is a defense. Section 3-303(b). Although Obligor has a defense against Obligee, if the instrument is negotiated to Holder and the requirements of subsection (a) are met, Holder may enforce the instrument against Obligor free of the defense. Section 3-305(b). In the typical case the holder in due course is not the payee of the instrument. Rather, the holder in due course is an immediate or remote transferee of the payee. If Obligor in our example is the only obligor on the check or note, the holder-in-due-course doctrine is irrelevant in determining rights between Obligor and Obligee with respect to the instrument.

But in a small percentage of cases it is appropriate to allow the payee of an instrument to assert rights as a holder in due course. The cases are like those referred to in the quotation from Professor Britton referred to above, or other cases in which conduct of some third party is the basis of the defense of the issuer of the instrument. The following are examples:

Case #1. Buyer pays for goods bought from Seller by giving to Seller a cashier's check bought from Bank. Bank has a defense to its obligation to pay the check because Buyer bought the check from Bank with a check known to be drawn on an account with insufficient funds to cover the check. If Bank issued the check to Buyer as payee and Buyer indorsed it over to Seller, it is clear that Seller can be a holder in due course taking free of the defense if Seller had no notice of the defense. Seller is a transferee of the check. There is no good reason why Seller's position should be any different if Bank drew the check to the order of Seller as payee. In that case, when Buyer took delivery of the check from Bank, Buyer became the owner of the check even though Buyer was not the holder. Buyer was a remitter. Section 3-103(a)(11). At that point nobody was the holder. When Buyer delivered the check to Seller, ownership of the check was transferred to Seller who also became the holder. This is a negotiation. Section 3-201. The rights of Seller should not be affected by the fact that in one case the negotiation to Seller was by a holder and in the other case the negotiation was by a remitter. Moreover, it should be irrelevant whether Bank delivered the check to Buyer and Buyer delivered it to Seller or whether Bank delivered it directly to Seller. In either case Seller can be a holder in due course that takes free of Bank's defense.

Case #2. X fraudulently induces Y to join X in a spurious venture to purchase a business. The purchase is to be financed by a bank loan for part of the price. Bank lends money to X and Y by deposit in a joint account of X and Y who sign a note payable to Bank for the amount of the loan. X then withdraws the money from the joint account and absconds. Bank acted in good faith and without notice of the fraud of X against Y. Bank is payee of the note executed by Y, but

its right to enforce the note against Y should not be affected by the fact that Y was induced to execute the note by the fraud of X. Bank can be a holder in due course that takes free of the defense of Y. Case #2 is similar to Case #1. In each case the payee of the instrument has given value to the person committing the fraud in exchange for the obligation of the person against whom the fraud was committed. In each case the payee was not party to the fraud and had no notice of it.

Suppose in Case #2 that the note does not meet the requirements of Section 3-104(a) and thus is not a negotiable instrument covered by Article 3. In that case, Bank cannot be a holder in due course but the result should be the same. Bank's rights are determined by general principles of contract law. Restatement Second, Contracts § 164(2) governs the case. If Y is induced to enter into a contract with Bank by a fraudulent misrepresentation by X, the contract is voidable by Y unless Bank "in good faith and without reason to know of the misrepresentation either gives value or relies materially on the transaction." Comment e to § 164(2) states: "This is the same principle that protects an innocent person who purchases goods or commercial paper in good faith, without notice and for value from one who obtained them from the original owner by a misrepresentation. See Uniform Commercial Code § § 2-403(1), 3-305. In the cases that fall within [§ 164 (2)], however, the innocent person deals directly with the recipient of the misrepresentation, which is made by one not a party to the contract."

The same result follows in Case #2 if Y had been induced to sign the note as an accommodation party (Section 3-419). If Y signs as comaker of a note for the benefit of X, Y is a surety with respect to the obligation of X to pay the note but is liable as maker of the note to pay Bank. Section 3-419(b). If Bank is a holder in due course, the fraud of X cannot be asserted against Bank under Section 3-305(b). But the result is the same without resort to holder-in-due-course doctrine. If the note is not a negotiable instrument governed by Article 3, general rules of suretyship apply. Restatement, Security § 119 states that the surety (Y) cannot assert a defense against the creditor (Bank) based on the fraud of the principal (X) if the creditor "without knowledge of the fraud * * * extended credit to the principal on the security of the surety's promise * * *." The underlying principle of § 119 is the same as that of § 164(2) of Restatement Second, Contracts.

Case #3. Corporation draws a check payable to Bank. The check is given to an officer of Corporation who is instructed to deliver it to Bank in payment of a debt owed by Corporation to Bank. Instead, the officer, intending to defraud Corporation, delivers the check to Bank in payment of the officer's personal debt, or the check is delivered to Bank for deposit to the officer's personal account. If Bank obtains payment of the check, Bank has received funds of Corporation which have been used for the personal benefit of the officer. Corporation in this case will assert a claim to the proceeds of the check against Bank. If Bank was a holder in due course of the check it took the check free of Corporation's claim. Section 3-306. The issue in this case is whether Bank had notice of the claim when it took the check. If Bank knew that the officer was a fiduciary with respect to the check, the issue is governed by Section 3-307.

Case #4. Employer, who owed money to X, signed a blank check and delivered it to Secretary with instructions to complete the check by typing in X's name and the amount owed to X. Secretary fraudulently completed the check by typing in the name of Y, a creditor to whom Secretary owed money. Secretary then delivered the check to Y in payment of Secretary's debt. Y obtained payment of the check. This case is similar to Case #3. Since Secretary was authorized to complete the check, Employer is bound by Secretary's act in making the check payable to Y. The drawee bank properly paid the check. Y received funds of Employer which were used for the personal benefit of Secretary. Employer asserts a claim to these funds against Y. If Y is a holder in due course, Y takes free of the claim. Whether Y is a holder in due course depends upon whether Y had notice of Employer's claim.

5. Subsection (c) is based on former Section 3-302(3). Like former Section 3-302(3), subsection (c) is intended to state existing case law. It covers a few situations in which the purchaser takes an instrument under unusual circumstances. The purchaser is treated as a successor in interest to the prior holder and can acquire no better rights. But if the prior holder was a holder in due course, the purchaser obtains rights of a holder in due course.

Subsection (c) applies to a purchaser in an execution sale or sale in bankruptcy. It applies equally to an attaching creditor or any other person who acquires the instrument by legal process or to a representative, such as an executor, administrator, receiver or assignee for the benefit of creditors, who takes the instrument as part of an estate. Subsection (c) applies to bulk purchases lying outside of the ordinary course of business of the seller. For example, it applies to the purchase by one bank of a substantial part of the paper held by another bank which is threatened with insolvency and seeking to liquidate its assets. Subsection (c) would also apply when a new partnership takes over for value all of the assets of an old one after a new member has entered the firm, or to a reorganized or consolidated corporation taking over the assets of a predecessor.

In the absence of controlling state law to the contrary, subsection (c) applies to a sale by a

state bank commissioner of the assets of an insolvent bank. However, subsection (c) may be preempted by federal law if the Federal Deposit Insurance Corporation takes over an insolvent bank. Under the governing federal law, the FDIC and similar financial institution insurers are given holder in due course status and that status is also acquired by their assignees under the shelter doctrine.

6. Subsection (d) and (e) clarify two matters not specifically addressed by former Article 3:

Case #5. Payee negotiates a $1,000 note to Holder who agrees to pay $900 for it. After paying $500, Holder learns that Payee defrauded Maker in the transaction giving rise to the note. Under subsection (d) Holder may assert rights as a holder in due course to the extent of $555.55 ($500 ÷ $900 = .555 X $1,000 = $555.55). This formula rewards Holder with a ratable portion of the bargained for profit.

Case #6. Payee negotiates a note of Maker for $1,000 to Holder as security for payment of Payee's debt to Holder of $600. Maker has a defense which is good against Payee but of which Holder has no notice. Subsection (e) applies. Holder may assert rights as a holder in due course only to the extent of $600. Payee does not get the benefit of the holder-in-due-course status of Holder. With respect to $400 of the note, Maker may assert any rights that Maker has against Payee. A different result follows if the payee of a note negotiated it to a person who took it as a holder in due course and that person pledged the note as security for a debt. Because the defense cannot be asserted against the pledgor, the pledgee can assert rights as a holder in due course for the full amount of the note for the benefit of both the pledgor and the pledgee.

7. There is a large body of state statutory and case law restricting the use of the holder in due course doctrine in consumer transactions as well as some business transactions that raise similar issues. Subsection (g) subordinates Article 3 to that law and any other similar law that may evolve in the future. Section 3-106(d) also relates to statutory or administrative law intended to restrict use of the holder-in-due-course doctrine. See Comment 3 to Section 3-106.

ANNOTATION

I. GENERAL CONSIDERATION.

Law reviews. For note, "Judicial Limitations on Holder in Due Course Claims", see 42 U. Colo. L. Rev. 439 (1971).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Applied in Hollemon v. Murray, 666 P.2d 1107 (Colo. App. 1982); La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

II. HOLDER IN DUE COURSE.

A. In General.

It is axiomatic that in order for one to be a holder in due course he must first be a holder. Walter E. Heller & Co. v. Mesa Bldg. Prods. Co., 233 F. Supp. 434 (D. Colo. 1964).

All presumptions under this section are in favor of the holder of an instrument. Civic Fin. Co. v. Meintzer, 137 Colo. 572, 328 P.2d 379 (1958).

Person can qualify as holder in due course through constructive possession. Person was holder in due course of check deposited into its bank account by authorized agent of another person despite fact that agent wrote check for own benefit. Physical possession of check was not required. Georg v. Metro Fixtures Contractors, Inc., 178 P.3d 1209 (Colo. 2008).

A payee on an instrument who deals directly with the drawer or issuer is not typically entitled to assert the rights of a holder in due course. Flatiron Linen, Inc. v. First Amer. State Bank, 1 P.3d 244 (Colo. App. 1999), rev'd on other grounds, 23 P.3d 1209 (Colo. 2001).

Allegation that payee was "holder in due course" is not a mere conclusion of law insufficient to state a claim for relief. Blake v. Samuelson, 34 Colo. App. 183, 524 P.2d 624 (1974).

Burden of proof is on holder where title is defective. When it is shown that the title of any individual who has negotiated a promissory note is defective, the burden is on the holder to prove that he acquired the title as a holder in due course. Delaney v. Brownwood, 73 Colo. 83, 213 P. 578 (1923).

Assignee of negotiable instrument suing thereon need not plead specific facts from which his assignor derives the status of a holder in due course. Blake v. Samuelson, 34 Colo. App. 183, 524 P.2d 624 (1974).

When a directed verdict may be entered. Where there is not sufficient evidence before the jury to contradict plaintiff's testimony that he is a holder in due course, a directed verdict is right. Neal v. Wilson County Bank, 83 Colo. 118, 263

P. 18 (1927). See Miller v. Farmers' Bank & Trust Co., 82 Colo. 373, 260 P. 112 (1927).

Where bank acquired a single promissory note from a trust, transaction could not be considered a bulk purchase under subsection (3)(c) because the successor organization did not acquire a substantial part of the paper held by the predecessor organization; and since it was not a bulk transaction, the purchase did not preclude the bank from becoming a holder in due course. First Nat. Bank v. Lohman, 827 P.2d 583 (Colo. App. 1992).

If the signers on a note are able to prove close connectedness between the original payee of the note and an assignee thereof, then such relationship effectively invalidates the assignee's claim to a holder in due course status and allows the defenses available against the payee also to be asserted against the assignee. Stotler v. Geibank Indus. Bank, 827 P.2d 608 (Colo. App. 1992).

Where bank acquired a single promissory note from a trust, transaction could not be considered a bulk purchase under subsection (3)(c) because the successor organization did not acquire a substantial part of the paper held by the predecessor organization; and since it was not a bulk transaction, the purchase did not preclude the bank from becoming a holder in due course. First Nat. Bank v. Lohman, 827 P.2d 583 (Colo. App. 1992) (decided under former § 4-3-302 (3)(c)).

If the signers on a note are able to prove close connectedness between the original payee of the note and an assignee thereof, then such relationship effectively invalidates the assignee's claim to a holder in due course status and allows the defenses available against the payee also to be asserted against the assignee. Stotler v. Geibank Indus. Bank, 827 P.2d 608 (Colo. App. 1992).

Applied in Terrell v. Walter E. Heller & Co., 165 Colo. 463, 439 P.2d 989 (1968).

B. For Value.

A bank does not become a holder for value merely by giving credit. Atkinson v. Englewood State Bank, 141 Colo. 436, 348 P.2d 702 (1960). See Delaney v. Brownwood, 73 Colo. 83, 213 P. 578 (1923).

Where a promissory note is given as collateral for a debt, the pledgee is a holder in due course for value, and he does not lose that character where the debt which is secured still exceeds the amount of the note although partly paid. Fredericksen v. City Nat'l Bank, 70 Colo. 553, 203 P. 659 (1922).

Negotiable instrument in form of a check shows prima facie consideration and therefore, payee's assignee, alleging in his suit on the check that payee was a holder in due course, is not required to allege facts which, if proven, would show that the maker was indebted to payee. Blake v. Samuelson, 34 Colo. App. 183, 524 P.2d 624 (1974).

C. In Good Faith.

Proof of payment of full value by holder raises a presumption of good faith, which, if not overcome, entitles him to judgment. Delaney v. Brownwood, 73 Colo. 83, 213 P. 578 (1923).

The "good faith" standard is a subjective one. Under a subjective standard, an absence of knowledge is not equivalent to a lack of good faith. Money Mart Check Cashing Center, Inc. v. Epicycle Corp., 667 P.2d 1372 (Colo. 1983).

If a note is taken by indorsement under circumstances which impute knowledge of infirmities in it so that the taking of it amounts to bad faith, the transferee is not a holder in due course. McClellan v. Morris, 71 Colo. 304, 206 P. 575 (1922).

Suspicions and surmises cannot be made to take the place of evidence, and to defeat the note, there must be evidence of actual knowledge of such facts that the action of the indorsee in taking the note constituted bad faith. Hukill v. McGinnis, 70 Colo. 455, 202 P. 110 (1921); Neal v. Wilson County Bank, 83 Colo. 118, 263 P. 18 (1927).

Bad faith must be shown. An indorsee of a check is presumed to have received it in good faith, and it will not be invalidated in the hands of such indorsee by suspicious circumstances attending its indorsement unless the circumstances are sufficient to show that it was taken in bad faith. Wedge Mines Co. v. Denver Nat'l Bank, 19 Colo. App. 182, 73 P. 873 (1903).

Bad faith in fact, or mala fides, is the opposite of good faith and consists in guilty knowledge, or willful ignorance, showing a vicious or evil mind. Burnham Loan & Inv. Co. v. Sethman, 64 Colo. 189, 171 P. 884 (1918); Hendrickson v. Alpert, 159 Colo. 463, 412 P.2d 433 (1966).

Such as corporate president who indorses corporation check to himself. A president of a corporation who in such capacity indorses to himself a note payable to the corporation does not thereby become a holder in due course free from the defenses of the maker against the corporation. Denver Suburban Homes & Water Co. v. Fugate, 63 Colo. 423, 168 P. 33 (1917).

Knowledge of obtaining notes by false representations. Where a bank buys and discounts a note with knowledge that the indorser has obtained other similar notes by means of false representations, this constitutes evidence of bad faith so that the bank is not a holder in due course. Platte Valley State Bank v. Burge, 73 Colo. 296, 215 P. 149 (1923).

Knowledge of fraud. In an action to obtain the return of a promissory note obtained by

fraud, where the person obtaining the note had knowledge of such facts, his action in taking the instrument amounted to bad faith, and therefore he is not a holder in due course. Myers v. Griffith, 108 Colo. 218, 115 P.2d 397 (1941).

In order to defeat a recovery on the ground of fraud in an action on a promissory note by one who acquired it for a consideration before maturity, the burden is on defendant to prove that at the time plaintiff acquired the note, he had actual knowledge of the fraud or knowledge of such facts that his action in taking the instrument amounted to bad faith. Abley v. Davies, 84 Colo. 398, 270 P. 880 (1928).

One who cashes a check without knowledge of adverse facts is a holder in due course and entitled to recovery from the drawer. Levitt v. Kerrigan, 109 Colo. 129, 122 P.2d 246 (1942).

"Good faith" unaffected by payee's account level. In the case of a bank cashing a check, if the bank establishes that the check was taken without notice of dishonor or of any other defense, this is sufficient to establish "good faith". The issue of good faith, to establish that the bank is a holder in due course, is unaffected by the fact that the payee's account is low or overdrawn at the time the check is cashed. Vail Nat'l Bank v. J. Wheeler Constr. Corp., 669 P.2d 1038 (Colo. App. 1983).

D. Without Notice.

One who has knowledge of all the facts of a transaction is not a holder in due course free from the equities of the maker against the original payee, even though he holds the note for valid consideration as a subsequent indorsee. Reiter v. Pollard, 75 Colo. 203, 225 P. 222 (1924).

One offered negotiable paper fair upon its face, and not due, is under no duty to inquire of the maker as to its validity. Burnham Loan & Inv. v. Sethman, 64 Colo. 189, 171 P. 884 (1918).

If there is nothing on the face of a negotiable instrument, or in the written indorsement or assignment, to notify the assignee that the instrument was originally given upon an illegal consideration (gambling debts excepted) or obtained through fraud, the assignee who pays value therefor, and takes the same in good faith before maturity, may recover as against the maker. And this fact is true even though such assignee be in possession of facts or circumstances sufficient to arouse suspicion in the mind of a person of ordinary prudence and though he is guilty of negligence in not first following up such information for the purpose of discovering the fraud or illegality to which the suspicious circumstances may point. This rule is founded upon commercial necessity, for the untrammeled circulation of these instruments is a matter of supreme importance in the vast field of mercantile transactions; drafts, bills of exchange and other negotiable instruments take the place of money, and circulate almost as freely. Hence, to hold that each assignee must, before accepting them, inquire into each and every suspicious circumstance bearing upon the original execution, or pointing to possible defenses in a suit between the original parties, would produce serious inconveniences to the commercial world. Hukill v. McGinnis, 70 Colo. 455, 202 P. 110 (1921); Hendrickson v. Alpert, 159 Colo. 463, 412 P.2d 433 (1966).

Even though bearing no revenue stamps. A promissory note, otherwise in due form, is complete and regular upon its face although it bears no revenue stamps, since the absence of revenue stamps is no notice to an indorsee of a promissory note of any infirmity in the instrument or defect in the title of the person negotiating it, is not a suspicious circumstance, and is no evidence that the note was taken in bad faith. Metro. State Bank v. McNutt, 73 Colo. 291, 215 P. 151 (1923).

Whether an instrument is complete and regular on its face is questionable where an officer of a payee bank testifies that in 90 to 100 percent of similar cases where instruments are signed blank, they are filled in when delivered to the bank. Atkinson v. Englewood State Bank, 141 Colo. 436, 34 P.2d 702 (1960).

Tests other than "actual knowledge" may be used in resolving the issue of whether an endorsee of a promissory note is a holder in due course including whether the holder had in his possession facts from which he had reason to know of the defenses "at the time in question". The critical time for such notice is when the party comes into possession of the note as a holder. Salter v. Vanotti, 42 Colo. App. 448, 599 P.2d 962 (1979).

Duty to inquire as to possible defenses. Where an instrument is regular on its face there is no duty on the part of a check cashing service to inquire as to possible defenses, unless circumstances of which the holder has knowledge are of such a nature that the failure to inquire reveals a deliberate desire to evade knowledge because of a fear that investigation would disclose the existence of a defense. Money Mart Check Cashing Center, Inc. v. Epicycle Corp., 667 P.2d 1372 (Colo. 1983).

When inquiry required. If the purchaser has actual knowledge of facts which would apprise him of possible irregularities some inquiry is required by the notice provisions of the UCC. Salter v. Vanotti, 42 Colo. App. 448, 599 P.2d 962 (1979).

Refusal to investigate. The protection afforded a holder in due course cannot be used to shield one who simply refuses to investigate when the facts known to him suggest an irregularity concerning the commercial paper he pur-

chases. Salter v. Vanotti, 42 Colo. App. 448, 599 P.2d 962 (1979).

Party held to have notice of defense sufficient to deny status as holder in due course. Ackmann v. Merchants Mtg. & Trust Corp., 659 P.2d 697 (Colo. App. 1982).

Party held to have notice of defense sufficient to deny status as holder in due course. See Ackmann v. Merchants Mtg. & Trust Corp., 659 P.2d 697 (Colo. App. 1982), rev'd on other grounds sub nom. Kopeikin v. Merchants Mortg. & Trust Corp., 679 P.2d 599 (Colo. 1984).

Instrument must be acquired before maturity. One of the essentials to constitute a holder in due course is that the instrument must have been acquired before maturity. First Nat'l Bank v. Lewis, 57 Colo. 124, 139 P. 1102 (1914).

One who acquires a note after its maturity is not a holder in due course. See Vigil v. Pacheco, 95 Colo. 405, 36 P.2d 766 (1934).

Certified check not mature before presentment. A check certified to the payee by the bank on which it is drawn as accepted payable at the same bank does not mature until presented to such bank for payment, and a purchaser by indorsement before such presentment is a holder in due course, but not after maturity. Citizens' Nat'l Bank v. First Nat'l Bank, 66 Colo. 426, 182 P. 12 (1919).

Record supported the trial court's finding that the bank had no notice of any offset against the promissory note where the note was current in its payments at the time of the transfer, the maker of the note made another payment thereon subsequent to the transfer to the bank, and the note itself did not specify any offset against it. First Nat. Bank v. Lohman, 827 P.2d 583 (Colo. App. 1992).

E. Facts Not Constituting Notice.

The fact that a promissory note is indorsed without recourse is not in itself sufficient to put a purchaser on inquiry. Omaha Steel Works v. Martin, 78 Colo. 560, 243 P. 619 (1926).

Knowledge that pledgor of note was treasurer of payee. Purchaser's knowledge, at the time of accepting a note, that the pledgor thereof was treasurer of the payee is not any evidence of bad faith on the part of the purchaser and insufficient to warrant any inference thereof where in pledging the note the pledgor exercised no function of treasurer. Burnham Loan & Inv. Co. v. Sethman, 64 Colo. 189, 171 P. 884 (1918).

Where director-purchaser relies on corporation's agents. The purchaser of a current note from an industrial corporation payee is not individually charged with knowledge of false representations made by agents of the corporation in procuring the note merely because he is a director in the corporation. Dodo v. Stocker, 74 Colo. 95, 219 P. 222 (1923).

F. Recordation Not Notice.

Constructive notice given by the recordation of instruments does not impute such knowledge as is contemplated by this section. Metro. State Bank v. McNutt, 73 Colo. 291, 215 P. 151 (1923).

G. Opportunity to Act.

An organization is charged with notice of infirmities relating to the procurement of a note when its principal officer obtains it, in which case, it is not entitled to protection as a holder in due course. Reserve Bldg. & Loan Ass'n v. Jamison, 108 Colo. 503, 119 P.2d 621 (1941).

When a company learns that its checks used in gambling by one of its employees have been paid by the bank, it cannot disaffirm and recover from the bank except by prompt action. Nat'l Surety Co. v. Stockyards Nat'l Bank, 84 Colo. 563, 272 P. 470 (1928).

III. PAYEE MAY BE H.D.C.

Title of payee of promissory note is defective when he negotiates it fraudulently or in breach of trust. Delaney v. Brownwood, 73 Colo. 83, 213 P. 578 (1923).

IV. WHEN NOT H.D.C.

A trustee in bankruptcy is not a bona fide purchaser for value but takes a note subject to all defenses the maker may have against the payee. Investors' Fin. Co. v. Bodnar, 87 Colo. 498, 289 P. 599 (1930).

4-3-303. Value and consideration. (a) An instrument is issued or transferred for value if:

(1) The instrument is issued or transferred for a promise of performance, to the extent the promise has been performed;

(2) The transferee acquires a security interest or other lien in the instrument other than a lien obtained by judicial proceeding;

(3) The instrument is issued or transferred as payment of, or as security for, an antecedent claim against any person, whether or not the claim is due;

(4) The instrument is issued or transferred in exchange for a negotiable instrument; or

(5) The instrument is issued or transferred in exchange for the incurring of an irrevocable obligation to a third party by the person taking the instrument.

(b) "Consideration" means any consideration sufficient to support a simple contract. The drawer or maker of an instrument has a defense if the instrument is issued without consideration. If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due and the promise has not been performed. If an instrument is issued for value as stated in subsection (a) of this section, the instrument is also issued for consideration.

Source: L. 94: Entire article R&RE, p. 855, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-303 as it existed prior to 1994.

OFFICIAL COMMENT

1. Subsection (a) is a restatement of former Section 3-303 and subsection (b) replaces former Section 3-408. The distinction between value and consideration in Article 3 is a very fine one. Whether an instrument is taken for value is relevant to the issue of whether a holder is a holder in due course. If an instrument is not issued for consideration the issuer has a defense to the obligation to pay the instrument. Consideration is defined in subsection (b) as "any consideration sufficient to support a simple contract." The definition of value in Section 1-201(44), which doesn't apply to Article 3, includes "any consideration sufficient to support a simple contract." Thus, outside Article 3, anything that is consideration is also value. A different rule applies in Article 3. Subsection (b) of Section 3-303 states that if an instrument is issued for value it is also issued for consideration.

Case #1. X owes Y $1,000. The debt is not represented by a note. Later X issues a note to Y for the debt. Under subsection (a)(3) X's note is issued for value. Under subsection (b) the note is also issued for consideration whether or not, under contract law, Y is deemed to have given consideration for the note.

Case #2. X issues a check to Y in consideration of Y's promise to perform services in the future. Although the executory promise is consideration for issuance of the check it is value only to the extent the promise is performed. Subsection (a)(1).

Case #3. X issues a note to Y in consideration of Y's promise to perform services. If at the due date of the note Y's performance is not yet due, Y may enforce the note because it was issued for consideration. But if at the due date of the note, Y's performance is due and has not been performed, X has a defense. Subsection (b).

2. Subsection (a), which defines value, has primary importance in cases in which the issue is whether the holder of an instrument is a holder in due course and particularly to cases in which the issuer of the instrument has a defense to the instrument. Suppose Buyer and Seller signed a contract on April 1 for the sale of goods to be delivered on May 1. Payment of 50% of the price of the goods was due upon signing of the contract. On April 1 Buyer delivered to Seller a check in the amount due under the contract. The check was drawn by X to Buyer as payee and was indorsed to Seller. When the check was presented for payment to the drawee on April 2, it was dishonored because X had stopped payment. At that time Seller had not taken any action to perform the contract with Buyer. If X has a defense on the check, the defense can be asserted against Seller who is not a holder in due course because Seller did not give value for the check. Subsection (a)(1). The policy basis for subsection (a)(1) is that the holder who gives an executory promise of performance will not suffer an out-of-pocket loss to the extent the executory promise is unperformed at the time the holder learns of dishonor of the instrument. When Seller took delivery of the check on April 1, Buyer's obligation to pay 50% of the price on that date was suspended, but when the check was dishonored on April 2 the obligation revived. Section 3-310(b). If payment for goods is due at or before delivery and the buyer fails to make the payment, the seller is excused from performing the promise to deliver the goods. Section 2-703. Thus, Seller is protected from an out-of-pocket loss even if the check is not enforceable. Holder-in-due-course status is not necessary to protect Seller.

3. Subsection (a)(2) equates value with the obtaining of a security interest or a nonjudicial lien in the instrument. The term "security interest" covers Article 9 cases in which an instrument is taken as collateral as well as bank collection cases in which a bank acquires a security interest under Section 4-210. The acquisition of a common-law or statutory banker's lien is also value under subsection (a)(2). An attaching creditor or other person who acquires a lien by judicial proceedings does not give value for the purposes of subsection (a)(2).

4. Subsection (a)(3) follows former Section 3-303(b) in providing that the holder takes for value if the instrument is taken in payment of or as security for an antecedent claim, even though there is no extension of time or other concession, and whether or not the claim is due. Sub-

section (a)(3) applies to any claim against any person; there is no requirement that the claim arise out of contract. In particular the provision is intended to apply to an instrument given in payment of or as security for the debt of a third person, even though no concession is made in return.

5. Subsection (a)(4) and (5) restate former Section 3-303(c). They state generally recognized exceptions to the rule that an executory promise is not value. A negotiable instrument is value because it carries the possibility of negotiation to a holder in due course, after which the party who gives it is obliged to pay. The same reasoning applies to any irrevocable commitment to a third person, such as a letter of credit issued when an instrument is taken.

ANNOTATION

I. GENERAL CONSIDERATION.

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

The giving of credit without more is not giving of value. Atkinson v. Englewood State Bank, 141 Colo. 436, 348 P.2d 702 (1960) (decided under repealed § 95-1-52, C.R.S. 1963, negotiable instruments law).

II. WANT OF CONSIDERATION AS A DEFENSE.

One cannot recover amount of a draft given without consideration, there being no question of the rights of an innocent holder. Moise Bros. Co. v. Jamison, 89 Colo. 278, 1 P.2d 925 (1931).

Partial failure of consideration is a defense pro tanto only to an action on a promissory note. Gillett v. Cheairs, 79 Colo. 20, 243 P. 1112 (1926).

Though vendor who is unable to convey title cannot recover on note given in part payment of the purchase price of the property, but having delivered possession, he is, in equity, entitled to protection. Gillett v. Cheairs, 79 Colo. 20, 243 P. 1112 (1926).

Where a guaranteed renewal note is given in payment of, or as security for an antecedent obligation to pay loan that maker obtained from bank, want of consideration is no defense to suit by bank against guarantors of note which is not paid by insolvent maker. State Bank v. Owens, 31 Colo. App. 351, 502 P.2d 965 (1972).

The validity of consideration created by antecedent debt is not affected by fact that the old note is not surrendered, provided there is no agreement to return the old note, which has not been transferred to one other than the payee of the new note. Wolf v. Larimer County Bank & Trust Co., 79 Colo. 376, 246 P. 285 (1926).

Nonperformance constitutes defense. Where the directors and stockholders of an insolvent state bank gave their individual notes to the bank which took over the assets on the promise of the latter to perform certain conditions, nonperformance of conditions constituted a defense to liability on the notes. Weicker v. Bromfield, 34 F.2d 377 (10th Cir. 1929).

Where the purpose is served. Where defendant executed notes in payment of his share of the expense of building a drain ditch the ditch being built and serving its purpose, he could not avoid payment of his notes because the ditch was not placed on a certain section line as provided in the agreement, under the contention that this constituted a failure of consideration. Fort v. Roberts, 82 Colo. 572, 261 P. 664 (1927).

III. PRESUMPTION OF CONSIDERATION.

Promissory note which shows on its face that it is given for value imports consideration. Neal v. Wilson County Bank, 83 Colo. 118, 263 P. 18 (1927).

Maker must overcome presumption of consideration. Since a note is prima facie presumed to be based on a valuable consideration and that one whose signature is placed thereon is presumed to have become a party for value, the maker, when sued by the payee, must overcome the presumption by showing, as an affirmative defense, that there was an absence or failure of consideration. Luby v. Jefferson County Bank, 28 Colo. App. 441, 476 P.2d 292 (1970).

Burden is on party pleading such. In an action on a promissory note, the burden of proving want or failure of consideration is on the party pleading it. James v. Ward, 80 Colo. 293, 250 P. 1097 (1926).

Absence of failure of consideration is an affirmative defense. Luby v. Jefferson County Bank, 28 Colo. App. 441, 476 P.2d 292 (1970).

Defense must be established by fair preponderance of evidence. Under this section a defendant who affirmatively pleads absence or failure of consideration has the burden of establishing his defense by a fair preponderance of the evidence, which burden remains with him throughout the trial. Hickman-Lunbeck Grocery Co. v. Hager, 75 Colo. 554, 227 P. 829 (1924).

Defense fails where no evidence. A duly executed promissory note imports consideration, and no evidence to the contrary being introduced, a defensive allegation of no consideration, fails. Viles v. Jackson, 105 Colo. 68, 94 P.2d 1085 (1939).

Failure of consideration for a promissory note may be shown by parol where the action is between the original parties to the note. Berta v. Rocchio, 149 Colo. 325, 369 P.2d 51 (1962).

Where agreement recites payment in full. Where notes are given in accordance with an agreement which recites they are payment in full for rights conveyed thereby, parol evidence cannot be introduced to prove there was to be additional consideration for the notes. Collins v. Shaffer, 66 Colo. 84, 179 P. 152 (1919).

Notwithstanding, presumption does not apply where fiduciary relationship. The general presumption of consideration of promissory notes is overcome by the specific presumption arising out of where there is a fiduciary relationship, in which case the claimant must overcome, by evidence, the presumption of undue influence with which the transaction is tainted because of the existence of the fiduciary relationship. Arnold v. Abernethy, 134 Colo. 573, 307 P.2d 1106 (1957).

IV. WHAT CONSTITUTES CONSIDERATION.

A. Adequate.

A benefit to the promisor or a detriment to the promisee can constitute consideration, however slight. Luby v. Jefferson County Bank, 28 Colo. App. 441, 476 P.2d 292 (1970).

A promise for a promise is a valid consideration. Denver Indus. Corp. v. Kesselring, 90 Colo. 295, 8 P.2d 767 (1932).

A single consideration which moves to any one of two or more comakers of a note will be adequate or sufficient to support the undertaking of them all. Luby v. Jefferson County Bank, 28 Colo. App. 441, 476 P.2d 292 (1970).

The fact that the proceeds of the loan go to a comaker of the note or to his designee does not constitute a lack or failure of consideration. Luby v. Jefferson County Bank, 28 Colo. App. 441, 476 P.2d 292 (1970).

Extension of the time for the payment of a sum of money is a sufficient consideration for the execution of a promissory note. Wheelock v. Hondius, 74 Colo. 400, 222 P. 404 (1924).

Extension of the time for the payment of a sum of money does not promise to continue paying interest. An extension for time of payment is not invalid for lack of consideration where such extension does not promise to continue to pay interest, for in such circumstances the promise to pay interest is implied. Adamson v. Bosick, 82 Colo. 309, 259 P. 513 (1927).

Where unpaid interest due after maturity is added to the past due principal and an extension of time is granted on the new amount, there is a valid consideration for the extension. Foote v. Larimer County Bank & Trust Co., 82 Colo. 323, 259 P. 1031 (1927).

Between the immediate parties, payment in advance of installment and interest payments on a promissory note are sufficient consideration for an extension agreement that future payments each year will be postponed until receipt of money from the annual sale of crops. Kuhlman v. McCormick, 116 Colo. 300, 180 P.2d 863 (1947).

For extension of time for payment of obligation constitutes consideration. State Bank v. Owens, 31 Colo. App. 351, 502 P.2d 965 (1972).

Including for attorney's fees. An extension of time for payment of an account is sufficient consideration for a provision for attorney's fees in notes taken. Taylor v. Continental Supply Co., 16 F.2d 578 (8th Cir. 1926).

Where a maker of a note makes a partial payment on it by a check of another which is dishonored and then subsequently makes another note for the amount of the check, the debt due the bank is sufficient consideration for the second note. Peterson v. First State Bank, 79 Colo. 494, 246 P. 784 (1926).

A preexisting debt is sufficient consideration for a promissory note. Beaman v. Stewart, 19 Colo. App. 226, 74 P. 344 (1903).

Preexisting debt sufficient consideration for check. Georg v. Metro Fixtures Contractors, Inc., 178 P.3d 1209 (Colo. 2008).

The debt of another. Where a promissory note of an individual is executed and received in satisfaction of the debt of another in whole, there is sufficient consideration for the new indebtedness. Lomax v. Colo. Nat'l Bank, 46 Colo. 229, 104 P. 85 (1909).

Settlement of a disputed claim is in itself sufficient consideration for the execution of a promissory note. Tisdel v. Central Sav. Bank & Trust Co., 90 Colo. 114, 6 P.2d 912 (1931). But see Moise Bros. Co. v. Jamison, 89 Colo. 278, 1 P.2d 925 (1931).

Even though the claim be of doubtful value. A note given in consideration of the settlement of a claim made in good faith, even though the claim be of doubtful value, is based on a valid consideration. Dixon v. Retallic, 80 Colo. 78, 249 P. 2 (1926). But see Moise Bros. Co. v. Jamison, 89 Colo. 278, 1 P.2d 925 (1931).

Forbearance in not suing on a promissory note is a valid consideration for the execution of a new note. James v. Ward, 80 Colo. 293, 250 P. 1097 (1926). But see Moise Bros. Co. v. Jamison, 89 Colo. 278, 1 P.2d 925 (1931).

The relinquishment of a void homestead entry whereby the entrant surrenders the land, thereby saving the expense of a contest, is sufficient consideration to support a note given in

payment for the relinquishment. Huff v. Geis, 71 Colo. 7, 203 P. 677 (1922).

An agreement to convey land is a sufficient consideration for a promissory note. Gillett v. Cheairs, 79 Colo. 20, 243 P. 1112 (1926).

A promissory note executed by a judgment debtor to his creditor is sufficient consideration for the release and satisfaction of the judgment. Blythe v. Cordingly, 20 Colo. App. 580, 80 P. 495 (1905).

Note signed by officer and stockholder to procure money for corporation is based on valid consideration. James v. Ward, 80 Colo. 293, 250 P. 1097 (1926). See Hunt v. Central Sav. Bank & Trust Co., 76 Colo. 480, 231 P. 60 (1925).

Note given to reduce excess loan to corporation. A promissory note given to a bank by an individual stockholder and officer of a corporation for the purpose of reducing the amount of an excess loan to his company, to which the state bank examiner had objected, is based upon a valid consideration. Rogers v. First State Bank, 79 Colo. 84, 243 P. 637 (1926). But see Cripple Creek State Bank v. Rollestone, 70 Colo. 434, 202 P. 115 (1921).

A stockholder who gives a note for money advanced by another to pay for a pro rata share of an anticipated assessment to restore impaired capital cannot allege lack of consideration for such note, as payment of the money discharged a liability as a stockholder. Campbell v. Hoch, 88 Colo. 303, 295 P. 798 (1931).

Where a party, after the discounting of a note, indorses it pursuant to a previous agreement, his act in signing relates back to the original contract and is supported by the same consideration. It is not necessary that he agreed to sign the note; rather, it is sufficient that the original maker promised to procure his signature and that he signed pursuant to such promise. Loveland v. Sigel-Campion Live Stock Co., 77 Colo. 22, 234 P. 168 (1925).

Where maker executes a note without consideration and the payee indorses it "without recourse", leaving such with the maker who credits payment thereon to reduce an amount equal to a loan from another to him by indorsing the note to this individual, the fact of no consideration as to the original transaction does not avail the maker as against this third party who took under an unqualified indorsement. Beach v. Bennett, 16 Colo. App. 459, 66 P. 567 (1901).

B. Inadequate.

A note given to a store for indebtedness is void for lack of consideration where the store does not credit the account for the amount of the note; since the indebtedness exists both prior and subsequent to the payment of the note there is no consideration. Daniels & Fisher Co. v. Allen, 66 Colo. 83, 179 P. 152 (1919).

Where a sales agreement gives the seller an election to terminate the agreement in the event of default and retain the payments made by the buyer as liquidated damages, and the seller so elects, a note given subsequent thereto by the buyer for defaulted payments is without consideration. Saunders v. Akers, 128 Colo. 100, 260 P.2d 596 (1953).

Where the cashier of a bank guarantees by indorsement a note held by the bank to maintain its capital and satisfy a bank examiner, the bank cannot maintain an action against the cashier, there being no consideration for the guarantee. Cripple Creek State Bank v. Rollestone, 70 Colo. 434, 202 P. 115 (1921). But see Rogers v. First State Bank, 79 Colo. 84, 243 P. 637 (1926).

Where a note is given to a corporation for corporate stock which will entitle the owner to purchase merchandise at the company's store at a reduced price, the subsequent failure of the company to build such a store invalidates the note for lack of consideration. Investors Fin. Co. v. Bodnar, 87 Colo. 498, 289 P. 599 (1930).

One who is induced to purchase stock in a corporation then being organized by the representation that the corporation is to limit its operations to the shipment of fruit grown by its stockholders, and that only by uniting with it will he be able to secure its service in the shipment of his fruit, may defeat an action upon a promissory note given for the stock by proof that, in fact, the corporation engaged in a general commission business and has refused and confessed itself unable to ship his fruit. Divine v. Western Slope Fruit Growers' Ass'n, 27 Colo. App. 368, 149 P. 841 (1915).

A note given by the maker to assist the payee in a scheme of the latter to defraud a creditor is void and unenforceable as between the parties, there being no other consideration. Abernethy v. Wright, 27 Colo. App. 239, 148 P. 277 (1915).

Agreement is void between executor and legatees. Since an agreement between an executor of a will and certain of the legatees for payment of certain sums as compensation, expenses, and attorney's fees is void, a promissory note given to effectuate the same is without consideration. Currier v. Clark, 15 Colo. App. 6, 60 P. 958 (1900).

Debt founded upon gambling consideration. Even in the hands of bona fide purchasers, negotiable paper founded in whole or in part upon a gambling or gaming consideration is utterly void. Western Nat'l Bank v. State Bank, 18 Colo. App. 128, 70 P. 439 (1902).

If a draft is given one in settlement of a dispute, he cannot recover thereon where the disputed claim is wholly without foundation. Moise Bros. Co. v. Jamison, 89 Colo. 278, 1 P.2d 925 (1931). But see Dixon v. Retallic, 80 Colo. 78, 249 P. 2 (1926); Tisdel v. Central Sav.

Bank & Trust Co., 90 Colo. 114, 6 P.2d 912 (1931).

No cause of action. If a draft is given for staying, discontinuing or dismissing litigation, one cannot recover thereon when he knows he has no cause of action. Moise Bros. Co. v. Jamison, 89 Colo. 278, 1 P.2d 925 (1931). But see James v. Ward, 80 Colo. 293, 250 P. 1097 (1926).

In addition, indorsement of a note pursuant to an arrangement after it has been executed, delivered, and discounted is without consideration, and judgment against the indorser erroneous. Loveland v. Sigel-Campion Live Stock Co., 77 Colo. 22, 234 P. 168 (1925).

4-3-304. Overdue instrument. (a) An instrument payable on demand becomes overdue at the earliest of the following times:

(1) On the day after the day demand for payment is duly made;

(2) If the instrument is a check, 90 days after its date; or

(3) If the instrument is not a check, when the instrument has been outstanding for a period of time after its date which is unreasonably long under the circumstances of the particular case in light of the nature of the instrument and usage of the trade.

(b) With respect to an instrument payable at a definite time the following rules apply:

(1) If the principal is payable in installments and a due date has not been accelerated, the instrument becomes overdue upon default under the instrument for nonpayment of an installment, and the instrument remains overdue until the default is cured.

(2) If the principal is not payable in installments and the due date has not been accelerated, the instrument becomes overdue on the day after the due date.

(3) If a due date with respect to principal has been accelerated, the instrument becomes overdue on the day after the accelerated due date.

(c) Unless the due date of principal has been accelerated, an instrument does not become overdue if there is default in payment of interest but no default in payment of principal.

Source: L. 94: Entire article R&RE, p. 855, § 1, effective January 1, 1995.

OFFICIAL COMMENT

1. To be a holder in due course, one must take without notice that an instrument is overdue. Section 3-302(a)(2)(iii). Section 3-304 replaces subsection (3) of former Section 3-304. For the sake of clarity it treats demand and time instruments separately. Subsection (a) applies to demand instruments. A check becomes stale after 90 days.

Under former Section 3-304(3)(c), a holder that took a demand note had notice that it was overdue if it was taken "more than a reasonable length of time after its issue." In substitution for this test, subsection (a)(3) requires the trier of fact to look at both the circumstances of the particular case and the nature of the instrument and trade usage. Whether a demand note is stale may vary a great deal depending on the facts of the particular case.

2. Subsections (b) and (c) cover time instruments. They follow the distinction made under former Article 3 between defaults in payment of principal and interest. In subsection (b) installment instruments and single payment instruments are treated separately. If an installment is late, the instrument is overdue until the default is cured.

ANNOTATION

The presumption that an indorsement of a promissory note is made before maturity is of little value where the indorsee took no action towards enforcing the note until more than 16 years after its maturity, as the claim was too stale to entitle him to invoke the presumption and this presumption is not intended to shield fraud or gross wrong against innocent persons nor to forgive inexcusable or unexplained laches or neglect. Guthrie v. Gibson, 67 Colo. 94, 184 P. 989 (1919) (decided under repealed laws antecedent to CSA, C. 112, § 45, negotiable instruments law).

4-3-305. Defenses and claims in recoupment. (a) Except as stated in subsection (b) of this section, the right to enforce the obligation of a party to pay an instrument is subject

to the following:

(1) A defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings;

(2) A defense of the obligor stated in another section of this article or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract; and

(3) A claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought.

(b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a) (1) of this section, but is not subject to defenses of the obligor stated in subsection (a) (2) of this section or claims in recoupment stated in subsection (a) (3) of this section against a person other than the holder.

(c) Except as stated in subsection (d) of this section, in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument (section 4-3-306) of another person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(d) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under subsection (a) of this section that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy, and lack of legal capacity.

Source: L. 94: Entire article R&RE, p. 856, § 1, effective January 1, 1995.

OFFICIAL COMMENT

1. Subsection (a) states the defenses to the obligation of a party to pay the instrument. Subsection (a)(1) states the "real defenses" that may be asserted against any person entitled to enforce the instrument.

Subsection (a)(1)(i) allows assertion of the defense of infancy against a holder in due course, even though the effect of the defense is to render the instrument voidable but not void. The policy is one of protection of the infant even at the expense of occasional loss to an innocent purchaser. No attempt is made to state when infancy is available as a defense or the conditions under which it may be asserted. In some jurisdictions it is held that an infant cannot rescind the transaction or set up the defense unless the holder is restored to the position held before the instrument was taken which, in the case of a holder in due course, is normally impossible. In other states an infant who has misrepresented age may be estopped to assert infancy. Such questions are left to other law, as an integral part of the policy of each state as to the protection of infants.

Subsection (a)(1)(ii) covers mental incompetence, guardianship, ultra vires acts or lack of corporate capacity to do business, or any other incapacity apart from infancy. Such incapacity is largely statutory. Its existence and effect is left to the law of each state. If under the state law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against a holder in due course. If the effect is merely to render the obligation voidable at the election of the obligor, the defense is cut off.

Duress, which is also covered by subsection (a)(ii), is a matter of degree. An instrument signed at the point of a gun is void, even in the hands of a holder in due course. One signed

under threat to prosecute the son of the maker for theft may be merely voidable, so that the defense is cut off. Illegality is most frequently a matter of gambling or usury, but may arise in other forms under a variety of statutes. The statutes differ in their provisions and the interpretations given them. They are primarily a matter of local concern and local policy. All such matters are therefore left to the local law. If under that law the effect of the duress or the illegality is to make the obligation entirely null and void, the defense may be asserted against a holder in due course. Otherwise it is cut off.

Subsection (a)(1)(iii) refers to "real" or "essential" fraud, sometimes called fraud in the essence or fraud in the factum, as effective against a holder in due course. The common illustration is that of the maker who is tricked into signing a note in the belief that it is merely a receipt or some other document. The theory of the defense is that the signature on the instrument is ineffective because the signer did not intend to sign such an instrument at all. Under this provision the defense extends to an instrument signed with knowledge that it is a negotiable instrument, but without knowledge of its essential terms. The test of the defense is that of excusable ignorance of the contents of the writing signed. The party must not only have been in ignorance, but must also have had no reasonable opportunity to obtain knowledge. In determining what is a reasonable opportunity all relevant factors are to be taken into account, including the intelligence, education, business experience, and ability to read or understand English of the signer. Also relevant is the nature of the representations that were made, whether the signer had good reason to rely on the representations or to have confidence in the person making them, the presence or absence of any third person who might read or explain the instrument to the signer, or any other possibility of obtaining independent information, and the apparent necessity, or lack of it, for acting without delay. Unless the misrepresentation meets this test, the defense is cut off by a holder in due course.

Subsection (a)(1)(iv) states specifically that the defense of discharge in insolvency proceedings is not cut off when the instrument is purchased by a holder in due course. "Insolvency proceedings" is defined in Section 1-201(22) and it includes bankruptcy whether or not the debtor is insolvent. Subsection (2)(e) of former Section 3-305 is omitted. The substance of that provision is stated in Section 3-601(b).

2. Subsection (a)(2) states other defenses that, pursuant to subsection (b), are cut off by a holder in due course. These defenses comprise those specifically stated in Article 3 and those based on common law contract principles. Article 3 defenses are nonissuance of the instrument, conditional issuance, and issuance for a special purpose (Section 3-105(b)); failure to countersign a traveler's check (Section 3-106(c)); modification of the obligation by a separate agreement (Section 3-117); payment that violates a restrictive indorsement (Section 3-206(f)); instruments issued without consideration or for which promised performance has not been given (Section 3-303(b)), and breach of warranty when a draft is accepted (Section 3-417(b)). The most prevalent common law defenses are fraud, misrepresentation or mistake in the issuance of the instrument. In most cases the holder in due course will be an immediate or remote transferee of the payee of the instrument. In most cases the holder-in-due-course doctrine is irrelevant if defenses are being asserted against the payee of the instrument, but in a small number of cases the payee of the instrument may be a holder in due course. Those cases are discussed in Comment 4 to Section 3-302.

Assume Buyer issues a note to Seller in payment of the price of goods that Seller fraudulently promises to deliver but which are never delivered. Seller negotiates the note to Holder who has no notice of the fraud. If Holder is a holder in due course, Holder is not subject to Buyer's defense of fraud. But in some cases an original party to the instrument is a holder in due course. For example, Buyer fraudulently induces Bank to issue a cashier's check to the order of Seller. The check is delivered by Bank to Seller, who has no notice of the fraud. Seller can be a holder in due course and can take the check free of Bank's defense of fraud. This case is discussed as Case #1 in Comment 4 to Section 3-302. Former Section 3-305 stated that a holder in due course takes free of defenses of "any party to the instrument with whom the holder has not dealt." The meaning of this language was not at all clear and if read literally could have produced the wrong result. In the hypothetical case, it could be argued that Seller "dealt" with Bank because Bank delivered the check to Seller. But it is clear that Seller should take free of Bank's defense against Buyer regardless of whether Seller took delivery of the check from Buyer or from Bank. The quoted language is not included in Section 3-305. It is not necessary. If Buyer issues an instrument to Seller and Buyer has a defense against Seller, that defense can obviously be asserted. Buyer and Seller are the only people involved. The holder-in-due-course doctrine has no relevance. The doctrine applies only to cases in which more than two parties are involved. Its essence is that the holder in due course does not have to suffer the consequences of a defense of the obligor on the instrument that arose from an occurrence with a third party.

3. Subsection (a)(3) is concerned with claims in recoupment which can be illustrated by the following example. Buyer issues a note to the order of Seller in exchange for a promise of Seller to deliver specified equipment. If Seller

fails to deliver the equipment or delivers equipment that is rightfully rejected, Buyer has a defense to the note because the performance that was the consideration for the note was not rendered. Section 3-303(b). This defense is included in Section 3-305(a)(2). That defense can always be asserted against Seller. This result is the same as that reached under former Section 3-408.

But suppose Seller delivered the promised equipment and it was accepted by Buyer. The equipment, however, was defective. Buyer retained the equipment and incurred expenses with respect to its repair. In this case, Buyer does not have a defense under Section 3-303(b). Seller delivered the equipment and the equipment was accepted. Under Article 2, Buyer is obliged to pay the price of the equipment which is represented by the note. But Buyer may have a claim against Seller for breach of warranty. If Buyer has a warranty claim, the claim may be asserted against Seller as a counterclaim or as a claim in recoupment to reduce the amount owing on the note. It is not relevant whether Seller is or is not a holder in due course of the note or whether Seller knew or had notice that Buyer had the warranty claim. It is obvious that holder-in-due-course doctrine cannot be used to allow Seller to cut off a warranty claim that Buyer has against Seller. Subsection (b) specifically covers this point by stating that a holder in due course is not subject to a "claim in recoupment * * * against a person other than the holder."

Suppose Seller negotiates the note to Holder. If Holder had notice of Buyer's warranty claim at the time the note was negotiated to Holder, Holder is not a holder in due course (Section 3-302(a)(2)(iv)) and Buyer may assert the claim against Holder (Section 3-305(a)(3)) but only as a claim in recoupment, i.e. to reduce the amount owed on the note. If the warranty claim is $1,000 and the unpaid note is $10,000, Buyer owes $9,000 to Holder. If the warranty claim is more than the unpaid amount of the note, Buyer owes nothing to Holder, but Buyer cannot recover the unpaid amount of the warranty claim from Holder. If Buyer had already partially paid the note, Buyer is not entitled to recover the amounts paid. The claim can be used only as an offset to amounts owing on the note. If Holder had no notice of Buyer's claim and otherwise qualifies as a holder in due course, Buyer may not assert the claim against Holder. Section 3-305(b).

The result under Section 3-305 is consistent with the result reached under former Article 3, but the rules for reaching the result are stated differently. Under former Article 3 Buyer could assert rights against Holder only if Holder was not a holder in due course, and Holder's status depended upon whether Holder had notice of a defense by Buyer. Courts have held that Holder had that notice if Holder had notice of Buyer's warranty claim. The rationale under former Article 3 was "failure of consideration." This rationale does not distinguish between cases in which the seller fails to perform and those in which the buyer accepts the performance of seller but makes a claim against the seller because the performance is faulty. The term "failure of consideration" is subject to varying interpretations and is not used in Article 3. The use of the term "claim in recoupment" in Section 3-305(a)(3) is a more precise statement of the nature of Buyer's right against Holder. The use of the term does not change the law because the treatment of a defense under subsection (a)(2) and a claim in recoupment under subsection (a)(3) is essentially the same.

Under former Article 3, case law was divided on the issue of the extent to which an obligor on a note could assert against a transferee who is not a holder in due course a debt or other claim that the obligor had against the original payee of the instrument. Some courts limited claims to those that arose in the transaction that gave rise to the note. This is the approach taken in Section 3-305(a)(3). Other courts allowed the obligor on the note to use any debt or other claim, no matter how unrelated to the note, to offset the amount owed on the note. Under current judicial authority and non-UCC statutory law, there will be many cases in which a transferee of a note arising from a sale transaction will not qualify as a holder in due course. For example, applicable law may require the use of a note to which there cannot be a holder in due course. See Section 3-106(d) and Comment 3 to Section 3-106. It is reasonable to provide that the buyer should not be denied the right to assert claims arising out of the sale transaction. Subsection (a)(3) is based on the belief that it is not reasonable to require the transferee to bear the risk that wholly unrelated claims may also be asserted. The determination of whether a claim arose from the transaction that gave rise to the instrument is determined by law other than this Article and thus may vary as local law varies.

4. Subsection (c) concerns claims and defenses of a person other than the obligor on the instrument. It applies principally to cases in which an obligation is paid with the instrument of a third person. For example, Buyer buys goods from Seller and negotiates to Seller a cashier's check issued by Bank in payment of the price. Shortly after delivering the check to Seller, Buyer learns that Seller had defrauded Buyer in the sale transaction. Seller may enforce the check against Bank even though Seller is not a holder in due course. Bank has no defense to its obligation to pay the check and it may not assert defenses, claims in recoupment, or claims to the instrument of Buyer, except to the extent permitted by the "but" clause of the first sentence of subsection (c). Buyer may have a claim to the instrument under Section 3-306 based on

a right to rescind the negotiation to Seller because of Seller's fraud. Section 3-202(b) and Comment 2 to Section 3-201. Bank cannot assert that claim unless Buyer is joined in the action in which Seller is trying to enforce payment of the check. In that case Bank may pay the amount of the check into court and the court will decide whether that amount belongs to Buyer or Seller. The last sentence of subsection (c) allows the issuer of an instrument such as a cashier's check to refuse payment in the rare case in which the issuer can prove that the instrument is a lost or stolen instrument and the person seeking enforcement does not have rights of a holder in due course.

5. Subsection (d) applies to instruments signed for accommodation (Section 3-419) and this subsection equates the obligation of the accommodation party to that of the accommodated party. The accommodation party can assert whatever defense or claim the accommodated party had against the person enforcing the instrument. The only exceptions are discharge in bankruptcy, infancy and lack of capacity. The same rule does not apply to an indorsement by a holder of the instrument in negotiating the instrument. The indorser, as transferor, makes a warranty to the indorsee, as transferee, that no defense or claim in recoupment is good against the indorser. Section 3-416(a)(4). Thus, if the indorsee sues the indorser because of dishonor of the instrument, the indorser may not assert the defense or claim in recoupment of the maker or drawer against the indorsee.

ANNOTATION

I. GENERAL CONSIDERATION.

Law reviews. For note, "Judicial Limitations on Holder in Due Course Claims", see 42 U. Colo. L. Rev. 439 (1971).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

A purchaser in good faith of a negotiable instrument before maturity and for value which is valid on its face may recover as against the maker. Civic Fin. Co. v. Meintzer, 137 Colo. 572, 328, P.2d 379 (1958).

Defendant has not established a defense as to the amount in dispute where the notes and foreclosure documents were properly admitted and were sufficient to establish the amount at issue. Smith v. Weindrop, 833 P.2d 856 (Colo. App. 1992).

Where the holder of a note acquires it after maturity, he holds it subject to every defense which the maker might have against a suit on it by the payee. First Nat'l Bank v. Lewis, 57 Colo. 124, 139 P. 1102 (1914).

A setoff is properly allowed. First Nat'l Bank v. Lewis, 57 Colo. 124, 139 P. 1102 (1914).

Defenses cannot destroy legal effect of note. A purchaser after maturity of a promissory note takes it subject to any defense the maker has against the payee, though such defenses may not destroy the legal effect of the note as such at the time it was made. Cooper v. German Nat'l Bank, 9 Colo. App. 169, 47 P. 1041 (1897).

Where fraud as a "real" defense is not available. Where fraud as a "real" defense (that is, fraud which is effective even as to a holder in due course) is not available, misrepresentations as to the character of the instrument signed is available only if the holder is not a holder in due course. Atkinson v. Englewood State Bank, 141 Colo. 436, 348 P.2d 702 (1960).

Right to immediate possession. While a showing of fraud, misrepresentation, or mistake may constitute a defense to payment, it does not establish the right to immediate possession, a necessary prerequisite to establishing a claim for conversion. Commercial Credit Corp. v. Univ. Nat'l Bank, 590 F.2d 849 (10th Cir. 1979).

Fraudulent representations in obtaining signature on a note-contract held a sufficient defense as against a holder not in due course. See Atkinson v. Englewood State Bank, 141 Colo. 436, 348 P.2d 702 (1960).

The defenses available in a contract action pursuant to this section are those defenses to the contract between the original payee and the co-makers and not those defenses grounded in contract solely between the co-makers. Armstrong v. Armstrong, 714 F. Supp. 451 (D. Colo. 1989).

Maker of check could not assert for itself as underlying obligor a third-party's defense of payoff, since "the claim of any third person to the instrument is not otherwise available as a defense to any party liable thereon unless the third person himself defends the action for such party". Lamson v. Commercial Credit Corp., 187 Colo. 382, 531 P.2d 966 (1975).

Applied in Condado Aruba Caribbean Hotel, N.V. v. Tickel, 39 Colo. App. 51, 561 P.2d 23 (1977); Salter v. Vanotti, 42 Colo. App. 448, 599 P.2d 962 (1979); Ackmann v. Merchants Mtg. & Trust Corp., 645 P.2d 7 (Colo. 1982); Meyers v. B.J. Johanningmeier, 735 P.2d 206 (Colo. App. 1987); Cole v. Farner, 749 P.2d 970 (Colo. App. 1987).

II. FREE FROM ALL CLAIMS.

An agent for collection cannot bind a holder in due course as principal by any collateral agreement concerning the note, such as releasing a joint maker upon his partial payment of the principal. Torbit v. Heath, 11 Colo. App. 492, 53 P. 615 (1898).

Bank not precluded by stop payment order. Where a bank credits the amount of a check deposited with it to the payee's account and permits him to draw against it, but payment is stopped by the maker, the bank can recover from the maker any amounts paid thereon, it being an innocent owner holding for value and without any notice of any defect in the instrument. Bromfield v. Cochran, 86 Colo. 486, 283 P. 45 (1929).

III. DEFENSES AND EXCEPTIONS.

A. In General.

Lack of consideration not a defense. The maker of a promissory note may not defend in an action against him by a bona fide holder in due course on the ground that the assignment to the holder was without consideration. Asiatic Tunnel Co. v. Stephenson, 63 Colo. 301, 165 P. 773 (1917).

One cannot avoid liability on a note even if it be conceded that there was a breach of contract between him and the original holder of the notes where one proves that he is a holder in due course and acquired the notes for value long before maturity without knowledge of any infirmity in the notes until after he had acquired them. Neal v. Wilson County Bank, 83 Colo. 118, 263 P. 18 (1927).

When duty to inquire as to defenses exists. Where an instrument is regular on its face there is no duty on the part of a check cashing service to inquire as to possible defenses, unless circumstances of which the holder in due course has knowledge are of such a nature that the failure to inquire reveals a deliberate desire to evade knowledge because of a fear that investigation would disclose the existence of a defense. Money Mart Check Cashing Center, Inc. v. Epicycle Corp., 667 P.2d 1372 (Colo. 1983).

The defense of fraudulent inducement is unavailable against a holder in due course and summary judgment was properly entered for holder of note. Stotler v. Geibank Indus. Bank, 827 P.2d 608 (Colo. App. 1992).

Maker's claim in her affidavit that she was deceived as to the nature of the document when she signed it is akin to asserting a claim of fraud in the factum and is a real defense which, if proved, defeats the rights of holder to collect under the note. Stotler v. Geibank Indus. Bank, 827 P.2d 608 (Colo. App. 1992).

Failure of a seller of land in a development to timely provide a HUD report to the buyer and the forgery of a buyer's signature can, in certain circumstances, provide a defense on a note against an assignee who might otherwise be a holder in due course. Stotler v. Geibank Indus. Bank, 827 P.2d 608 (Colo. App. 1992).

If the signers on a note are able to prove close connectedness between the original payee of the note and an assignee thereof, then such relationship effectively invalidates the assignee's claim to a holder in due course status and allows the defenses available against the payee also to be asserted against the assignee. Stotler v. Geibank Indus. Bank, 827 P.2d 608 (Colo. App. 1992).

B. Duress.

Threat of sending husband to penitentiary is duress. Where a wife, who is old and in poor health, executes a note under a threat to send her husband, who is even older than she, to the penitentiary, there is duress which voids the note; and such duress is a continuing one which is not waived by the execution of a renewal of such note. Union Nat'l Bank v. Wright, 79 Colo. 574, 247 P. 453 (1926).

Refusal to release deed of trust is not duress. The declaration of a creditor that he would not release a deed of trust on a debtor's property unless the debtor signed a promissory note does not constitute duress in law. Marquart v. Clark, 109 Colo. 62, 121 P.2d 885 (1942).

C. Illegality.

Defense based on gaming is good. No assignment of any negotiable paper where the whole or any part of the consideration thereof arises out of any gaming transaction offsets the statutory defense of the person executing such, as it is absolutely null and void, even in the hands of an innocent purchaser for value. Western Nat'l Bank v. State Bank, 18 Colo. App. 128, 70 P. 439 (1902).

One indorsing and assigning a negotiable instrument in another state in payment of a gambling loss cannot defend an action on such as against an innocent purchaser for value before maturity notwithstanding the gaming statute where the law which prevails in the state where the assignment was made permits such to be good in the hands of an innocent purchaser, provided the law of the state concerned is not so shocking to the moral sense of the community so as to make an exception to the rule that in suits on contracts the "lex loci" controls. Sullivan v. German Nat'l Bank, 18 Colo. App. 99, 70 P. 162 (1902).

D. Misrepresentation.

Answer alleging fraud states a defense. In an action upon an accepted bill of exchange by

an indorsee thereof, an answer setting forth fraud on the part of the drawer and payee and that the indorsee is not a holder in good faith but a mere agent of the drawer for collection states a defense. Johnson County Sav. Bank v. Gregg, 51 Colo. 358, 117 P. 1003 (1911).

Which is a jury question. The issue whether a note was induced by fraud is a question for the jury. Atkinson v. Englewood State Bank, 141 Colo. 436, 348 P.2d 702 (1960).

In an action on a renewal note where the defense is fraudulent representations in procurement of the original note, the renewal note itself is evidence tending to show waiver of the fraud, but it still must be shown that the note was renewed with the intention of waiving the fraud. First Nat'l Bank v. Navins, 70 Colo. 491, 202 P. 702 (1921).

Fraud held not a defense as against holder in due course. See Metro. State Bank v. McNutt, 73 Colo. 291, 215 P. 151 (1923); Abley v. Davies, 84 Colo. 398, 270 P. 880 (1928).

IV. CONDITIONS PRECEDENT AND DELIVERY.

Law reviews. For note, "Conditional Delivery of Negotiable Instruments in Colorado", see 13 Rocky Mt. L. Rev. 248 (1941).

Ordinarily a promissory note is prima facie evidence of an obligation enforceable as to its legal import, but while in the hands of the payee, the way is always open to the maker to prove circumstances showing that it never was made or delivered with the intention that it should be binding at all events; and he may not be foreclosed from establishing, if he can, that in effect it was no contract at all. McCaffrey v. Mitchell, 98 Colo. 467, 56 P.2d 926, 57 P.2d 900 (1936).

This section permits the payor of a note to show that he delivered it conditionally or for a special purpose only, and not for the purpose of transferring the property in the instrument, where the note is in the hands of the original payee who brings suit on it. Divine v. Western Slope Fruit Growers' Ass'n, 27 Colo. App. 368, 149 P. 841 (1915).

As between the immediate parties to a promissory note, delivery may be shown to be conditional or for a special purpose. Wheelock v. Hondius, 74 Colo. 400, 222 P. 404 (1924); Rock River Inv. Co. v. Mountain Fin. Corp., 94 Colo. 539, 31 P.2d 914 (1934).

Delivery may be shown by oral testimony. Wheelock v. Hondius, 74 Colo. 400, 222 P. 404 (1924); Rock River Inv. Co. v. Mountain Fin. Corp., 94 Colo. 539, 31 P.2d 914 (1934).

Since the parol evidence rule permits the reception of oral testimony of a contemporaneous oral agreement to show conditional delivery. Wheelock v. Hondius, 74 Colo. 400, 222 P. 404 (1924).

There is nothing in the negotiable instrument law, nor in the statute of frauds, that requires a contract of conditional delivery to be in writing; this fact being so, it of course may rest in parol. Norman v. McCarthy, 56 Colo. 290, 138 P. 28 (1914).

Parol evidence has not the effect to contradict or vary the terms of a writing, but merely shows the want of an element essential to its character as a contract — to wit, unconditional delivery. Norman v. McCarthy, 56 Colo. 290, 138 P. 28 (1914); Denison Clay Co. v. Pennock, 95 Colo. 20, 32 P.2d 189 (1934).

Parol evidence has not the effect to show that note is not to be paid at all. See Wheelock v. Hondius, 74 Colo. 400, 222 P. 404 (1924); Denver Indus. Corp. v. Kesselring, 90 Colo. 295, 8 P.2d 767 (1932).

The oral agreement constituting delivery must be contemporaneous with, and not prior to, the physical delivery of the instrument. Wheelock v. Hondius, 74 Colo. 400, 222 P. 404 (1924); Rock River Inv. Co. v. Mountain Fin. Corp., 94 Colo. 539, 31 P.2d 914 (1934). See Hall v. Farmers' Bank, 74 Colo. 165, 220 P. 237 (1923).

One who executes a promissory note payable to a principal and delivers it to his agent cannot defend on the note as to a collateral agreement with the agent for conditional payment in the absence of showing authorization of the agent. McIntosh-Huntington Co. v. Rice, 13 Colo. App. 393, 58 P. 358 (1899).

As burden of proof on asserting party. That the delivery of a promissory note was conditional must be established by the party who asserts it when pleaded. Hickman-Lunbeck Grocery Co. v. Hager, 75 Colo. 554, 227 P. 829 (1924).

Evidence of entire agreement is admissible. When a transaction involving the giving of a promissory note is questioned, evidence disclosing the entire agreement is always admissible. McCaffrey v. Mitchell, 98 Colo. 467, 56 P.2d 926, 57 P.2d 900 (1936).

Though defense of conditional delivery cannot be aided by allegations of want of consideration. Hickman-Lunbeck Grocery Co. v. Hager, 75 Colo. 554, 227 P. 829 (1924).

Where a defendant who assumed and agreed to pay the promissory note of another contends that the plaintiff is bound by a contemporaneous oral agreement as to the time and manner of payment so as to bring the case within an exception to the parol evidence rule, such a question of conditional delivery of a written instrument is not within the meaning of this section which is quite different from the question of the assumption of the note, and hence the contention is to be rejected. Index Shale Oil Co. v. Wheeler, 81 Colo. 402, 255 P. 982 (1927).

Where a promissory note is delivered upon parol condition that it shall be without effect in certain event, and the event specified occurs, no action lies thereon by the payee against the maker. Sayre v. Leonard, 57 Colo. 116, 140 P. 196 (1914).

Temporary security for a loan. Where a promissory note is in the hands of the corporation payee, named therein, the maker may defeat an action thereon by showing under proper averment that he subscribed the paper solely to enable the corporation to pledge it temporarily with a bank as security for a loan, that the loan was in fact made, and the note afterwards restored to the corporation. Divine v. Western Slope Fruit Growers' Ass'n, 27 Colo. App. 368, 149 P. 841 (1915), modifying Cooper v. German Nat'l Bank, 9 Colo. App. 169, 47 P. 1041 (1897).

Where a condition has not been performed. In an action upon an instrument by payee against the drawer, the drawer may, under this section, show by parol that the instrument was delivered upon a condition which has not been performed and which has become impossible of performance. Norman v. McCarthy, 56 Colo. 290, 138 P. 28 (1914).

Being signed by another. Promissory notes signed and delivered under an express agreement and condition that they are not to become obligatory until signed by another person also are void at the option of the maker in the hands of the original payee, and a "quia timet" action will lie for delivery up and cancellation of the notes. Dygert v. Clem, 26 Colo. App. 286, 143 P. 823 (1914).

Where payment is to be paid from dividends. In an action by an assignee after maturity, upon a note where a corporation was the payee, a parol agreement made contemporaneous with the execution of the note to the effect that the note would be paid from the maker's share in the dividends of the corporation, and not otherwise, is a complete defense to the action. George v. Williams, 27 Colo. App. 400, 149 P. 837 (1915).

Where a bank check is given under condition that drawer "made collections to pay it", the condition not being fulfilled, judgment is properly given for defendant. Miller v. Maxwell, 82 Colo. 540, 261 P. 1116 (1927).

Condition of prescribed purchase for maker gives negotiation right. The delivery of a note which is conditioned on an agreement that the payee will use the proceeds thereof in making a prescribed purchase for the maker carries with it the right of negotiation without which it would be valueless. Greenless v. Chezik, 68 Colo. 521, 190 P. 667 (1920).

An indorsee for value can recover against the maker even though he had knowledge of the conditions of the delivery. Greenless v. Chezik, 68 Colo. 521, 190 P. 667 (1920).

Even a purchaser for value cannot take negotiable paper freed from conditions attached of which he knows. Weicker v. Bromfield, 34 F.2d 377 (10th Cir. 1929).

Latter special indorsement superseded restrictive indorsement. Where a depository bank specially indorsed a check to the plaintiff, who became a holder in his own right, payment by the maker to the plaintiff was not contrary to a restrictive indorsement "pay any bank", because the latter special indorsement superseded the restrictive indorsement and such action by the depository bank was the equivalent of a constructive cancellation. Thus, any satisfaction to the ensuing holder was not inconsistent with the terms of the previous restrictive indorsement. Lamson v. Commercial Credit Corp., 187 Colo. 382, 531 P.2d 966 (1975).

4-3-306. Claims to an instrument. A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument.

Source: L. 94: Entire article R&RE, p. 857, § 1, effective January 1, 1995.

OFFICIAL COMMENT

This section expands on the reference to "claims to" the instrument mentioned in former Sections 3-305 and 3-306. Claims covered by the section include not only claims to ownership but also any other claim of a property or possessory right. It includes the claim to a lien or the claim of a person in rightful possession of an instrument who was wrongfully deprived of possession. Also included is a claim based on Section 3-202(b) for rescission of a negotiation of the instrument by the claimant. Claims to an instrument under Section 3-306 are different from claims in recoupment referred to in Section 3-305(a)(3).

4-3-307. Notice of breach of fiduciary duty. (a) In this section:

(1) "Fiduciary" means an agent, trustee, partner, corporate officer or director, or other representative owing a fiduciary duty with respect to an instrument.

(2) "Represented person" means the principal, beneficiary, partnership, corporation, or other person to whom the duty stated in paragraph (1) of this subsection (a) is owed.

(b) If (i) an instrument is taken from a fiduciary for payment or collection or for value, (ii) the taker has knowledge of the fiduciary status of the fiduciary, and (iii) the represented person makes a claim to the instrument or its proceeds on the basis that the transaction of the fiduciary is a breach of fiduciary duty, the following rules apply:

(1) Notice of breach of fiduciary duty by the fiduciary is notice of the claim of the represented person.

(2) In the case of an instrument payable to the represented person or the fiduciary as such, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary or (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary.

(3) If an instrument is issued by the represented person or the fiduciary as such, and made payable to the fiduciary personally, the taker does not have notice of the breach of fiduciary duty unless the taker knows of the breach of fiduciary duty.

(4) If an instrument is issued by the represented person or the fiduciary as such, to the taker as payee, the taker has notice of the breach of fiduciary duty if the instrument is (i) taken in payment of or as security for a debt known by the taker to be the personal debt of the fiduciary, (ii) taken in a transaction known by the taker to be for the personal benefit of the fiduciary, or (iii) deposited to an account other than an account of the fiduciary, as such, or an account of the represented person.

Source: L. 94: Entire article R&RE, p. 857, § 1, effective January 1, 1995. **L. 2000:** (b)(2) amended, p. 1173, § 3, effective May 26.

Cross references: For registration, see part 4 of this article.

OFFICIAL COMMENT

1. This section states rules for determining when a person who has taken an instrument from a fiduciary has notice of a breach of fiduciary duty that occurs as a result of the transaction with the fiduciary. Former Section 3-304(2) and (4)(e) related to this issue, but those provisions were unclear in their meaning. Section 3-307 is intended to clarify the law by stating rules that comprehensively cover the issue of when the taker of an instrument has notice of breach of a fiduciary duty and thus notice of a claim to the instrument or its proceeds.

2. Subsection (a) defines the terms "fiduciary" and "represented person" and the introductory paragraph of subsection (b) describes the transaction to which the section applies. The basic scenario is one in which the fiduciary in effect embezzles money of the represented person by applying the proceeds of an instrument that belongs to the represented person to the personal use of the fiduciary. The person dealing with the fiduciary may be a depositary bank that takes the instrument for collection or a bank or other person that pays value for the instrument. The section also covers a transaction in which an instrument is presented for payment to a payor bank that pays the instrument by giving value to the fiduciary. Subsections (b)(2), (3), and (4) state rules for determining when the person dealing with the fiduciary has notice of breach of fiduciary duty. Subsection (b)(1) states that notice of breach of fiduciary duty is notice of the represented person's claim to the instrument or its proceeds.

Under Section 3-306, a person taking an instrument is subject to a claim to the instrument or its proceeds, unless the taker has rights of a holder in due course. Under Section 3-302(a)(2)(v), the taker cannot be a holder in due course if the instrument was taken with notice of a claim under Section 3-306. Section 3-307 applies to cases in which a represented person is asserting a claim because a breach of fiduciary duty resulted in a misapplication of the proceeds of an instrument. The claim of the represented person is a claim described in Section 3-306. Section 3-307 states rules for determining when a person taking an instrument has notice of the claim which will prevent assertion of rights as a holder in due course. It also states rules for determining when a payor bank pays an instrument with notice of breach of fiduciary duty.

Section 3-307(b) applies only if the person dealing with the fiduciary "has knowledge of the fiduciary status of the fiduciary." Notice which does not amount to knowledge is not enough to cause Section 3-307 to apply. "Knowledge" is defined in Section 1-201(25). In most cases, the "taker" referred to in Section 3-307 will be a bank or other organization. Knowledge of an organization is determined by the rules stated in Section 1-201(27). In many cases, the individual who receives and processes an instrument on behalf of the organization that is the taker of the instrument "for payment or collection or for value" is a clerk who has no knowledge of any fiduciary status of the person from whom the instrument is received. In such cases, Section 3-307 doesn't apply because, under Section 1-201(27), knowledge of the organization is determined by the knowledge of the "individual conducting that transaction," i.e. the clerk who receives and processes the instrument. Furthermore, paragraphs (2) and (4) each require that the person acting for the organization have knowledge of facts that indicate a breach of fiduciary duty. In the case of an instrument taken for deposit to an account, the knowledge is found in the fact that the deposit is made to an account other than that of the represented person or a fiduciary account for benefit of that person. In other cases the person acting for the organization must know that the instrument is taken in payment or as security for a personal debt of the fiduciary or for the personal benefit of the fiduciary. For example, if the instrument is being used to buy goods or services, the person acting for the organization must know that the goods or services are for the personal benefit of the fiduciary. The requirement that the taker have knowledge rather than notice is meant to limit Section 3-307 to relatively uncommon cases in which the person who deals with the fiduciary knows all the relevant facts: the fiduciary status and that the proceeds of the instrument are being used for the personal debt or benefit of the fiduciary or are being paid to an account that is not an account of the represented person or of the fiduciary, as such. Mere notice of these facts is not enough to put the taker on notice of the breach of fiduciary duty and does not give rise to any duty of investigation by the taker.

3. Subsection (b)(2) applies to instruments payable to the represented person or the fiduciary as such. For example, a check payable to Corporation is indorsed in the name of Corporation by Doe as its President. Doe gives the check to Bank as partial repayment of a personal loan that Bank had made to Doe. The check was indorsed either in blank or to Bank. Bank collects the check and applies the proceeds to reduce the amount owed on Doe's loan. If the person acting for Bank in the transaction knows that Doe is a fiduciary and that the check is being used to pay a personal obligation of Doe, subsection (b)(2) applies. If Corporation has a claim to the proceeds of the check because the use of the check by Doe was a breach of fiduciary duty, Bank has notice of the claim and did not take the check as a holder in due course. The same result follows if Doe had indorsed the check to himself before giving it to Bank. Subsection (b)(2) follows Uniform Fiduciaries Act §4 in providing that if the instrument is payable to the fiduciary, as such, or to the represented person, the taker has notice of a claim if the instrument is negotiated for the fiduciary's personal debt. If fiduciary funds are deposited to a personal account of the fiduciary or to an account that is not an account of the represented person or of the fiduciary, as such, there is a split of authority concerning whether the bank is on notice of a breach of fiduciary duty. Subsection (b)(2)(iii) states that the bank is given notice of breach of fiduciary duty because of the deposit. The Uniform Fiduciaries Act §9 states that the bank is not on notice unless it has knowledge of facts that makes its receipt of the deposit an act of bad faith.

The rationale of subsection (b)(2) is that it is not normal for an instrument payable to the represented person or the fiduciary, as such, to be used for the personal benefit of the fiduciary. It is likely that such use reflects an unlawful use of the proceeds of the instrument. If the fiduciary is entitled to compensation from the represented person for services rendered or for expenses incurred by the fiduciary the normal mode of payment is by a check drawn on the fiduciary account to the order of the fiduciary.

4. Subsection (b)(3) is based on Uniform Fiduciaries Act §6 and applies when the instrument is drawn by the represented person or the fiduciary as such to the fiduciary personally. The term "personally" is used as it is used in the Uniform Fiduciaries Act to mean that the instrument is payable to the payee as an individual and not as a fiduciary. For example, Doe as President of Corporation writes a check on Corporation's account to the order of Doe personally. The check is then indorsed over to Bank as in Comment 3. In this case there is no notice of breach of fiduciary duty because there is nothing unusual about the transaction. Corporation may have owed Doe money for salary, reimbursement for expenses incurred for the benefit of Corporation, or for any other reason. If Doe is authorized to write checks on behalf of Corporation to pay debts of Corporation, the check is a normal way of paying a debt owed to Doe. Bank may assume that Doe may use the instrument for his personal benefit.

5. Subsection (b)(4) can be illustrated by a hypothetical case. Corporation draws a check payable to an organization. X, an officer or employee of Corporation, delivers the check to a person acting for the organization. The person

signing the check on behalf of Corporation is X or another person. If the person acting for the organization in the transaction knows that X is a fiduciary, the organization is on notice of a claim by Corporation if it takes the instrument under the same circumstances stated in subsection (b)(2). If the organization is a bank and the check is taken in repayment of a personal loan of the bank to X, the case is like the case discussed in Comment 3. It is unusual for Corporation, the represented person, to pay a personal debt of Doe by issuing a check to the bank. It is more likely that the use of the check by Doe reflects an unlawful use of the proceeds of the check. The same analysis applies if the check is made payable to an organization in payment of goods or services. If the person acting for the organization knew of the fiduciary status of X and that the goods or services were for X's personal benefit, the organization is on notice of a claim by Corporation to the proceeds of the check. See the discussion in the last paragraph of Comment 2.

4-3-308. Proof of signatures and status as holder in due course. (a) In an action with respect to an instrument, the authenticity of, and authority to make, each signature on the instrument is admitted unless specifically denied in the pleadings. If the validity of a signature is denied in the pleadings, the burden of establishing validity is on the person claiming validity, but the signature is presumed to be authentic and authorized unless the action is to enforce the liability of the purported signer and the signer is dead or incompetent at the time of trial of the issue of validity of the signature. If an action to enforce the instrument is brought against a person as the undisclosed principal of a person who signed the instrument as a party to the instrument, the plaintiff has the burden of establishing that the defendant is liable on the instrument as a represented person under section 4-3-402 (a).

(b) If the validity of signatures is admitted or proved and there is compliance with subsection (a) of this section, a plaintiff producing the instrument is entitled to payment if the plaintiff proves entitlement to enforce the instrument under section 4-3-301, unless the defendant proves a defense or claim in recoupment. If a defense or claim in recoupment is proved, the right to payment of the plaintiff is subject to the defense or claim, except to the extent the plaintiff proves that the plaintiff has rights of a holder in due course which are not subject to the defense or claim.

Source: L. 94: Entire article R&RE, p. 858, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-307 as it existed prior to 1994.

OFFICIAL COMMENT

1. Section 3-308 is a modification of former Section 3-307. The first two sentences of subsection (a) are a restatement of former Section 3-307(1). The purpose of the requirement of a specific denial in the pleadings is to give the plaintiff notice of the defendant's claim of forgery or lack of authority as to the particular signature, and to afford the plaintiff an opportunity to investigate and obtain evidence. If local rules of pleading permit, the denial may be on information and belief, or it may be a denial of knowledge or information sufficient to form a belief. It need not be under oath unless the local statutes or rules require verification. In the absence of such specific denial the signature stands admitted, and is not in issue. Nothing in this section is intended, however, to prevent amendment of the pleading in a proper case.

The question of the burden of establishing the signature arises only when it has been put in issue by specific denial. "Burden of establishing" is defined in Section 1-201. The burden is on the party claiming under the signature, but the signature is presumed to be authentic and authorized except as stated in the second sentence of subsection (a). "Presumed" is defined in Section 1-201 and means that until some evidence is introduced which would support a finding that the signature is forged or unauthorized, the plaintiff is not required to prove that it is valid. The presumption rests upon the fact that in ordinary experience forged or unauthorized signatures are very uncommon, and normally any evidence is within the control of, or more accessible to, the defendant. The defendant is therefore required to make some sufficient showing of the grounds for the denial before the plaintiff is required to introduce evidence. The defendant's evidence need not be sufficient to require a directed verdict, but it must be enough to support the denial by permitting a finding in the defendant's favor. Until introduction of such evidence the presumption requires a finding for the plaintiff. Once such evidence is introduced the burden of establishing the signature by a preponderance of the total evidence is on the

plaintiff. The presumption does not arise if the action is to enforce the obligation of a purported signer who has died or become incompetent before the evidence is required, and so is disabled from obtaining or introducing it. "Action" is defined in Section 1-201 and includes a claim asserted against the estate of a deceased or an incompetent.

The last sentence of subsection (a) is a new provision that is necessary to take into account Section 3-402(a) that allows an undisclosed principal to be liable on an instrument signed by an authorized representative. In that case the person enforcing the instrument must prove that the undisclosed principal is liable.

2. Subsection (b) restates former Section 3-307(2) and (3). Once signatures are proved or admitted a holder, by mere production of the instrument, proves "entitlement to enforce the instrument" because under Section 3-301 a holder is a person entitled to enforce the instrument. Any other person in possession of an instrument may recover only if that person has the rights of a holder. Section 3-301. That person must prove a transfer giving that person such rights under Section 3-203(b) or that such rights were obtained by subrogation or succession.

If a plaintiff producing the instrument proves entitlement to enforce the instrument, either as a holder or a person with rights of a holder, the plaintiff is entitled to recovery unless the defendant proves a defense or claim in recoupment. Until proof of a defense or claim in recoupment is made, the issue as to whether the plaintiff has rights of a holder in due course does not arise. In the absence of a defense or claim in recoupment, any person entitled to enforce the instrument is entitled to recover. If a defense or claim in recoupment is proved, the plaintiff may seek to cut off the defense or claim in recoupment by proving that the plaintiff is a holder in due course or that the plaintiff has rights of a holder in due course under Section 3-203(b) or by subrogation or succession. All elements of Section 3-302(a) must be proved.

Nothing in this section is intended to say that the plaintiff must necessarily prove rights as a holder in due course. The plaintiff may elect to introduce no further evidence, in which case a verdict may be directed for the plaintiff or the defendant, or the issue of the defense or claim in recoupment may be left to the trier of fact, according to the weight and sufficiency of the defendant's evidence. The plaintiff may elect to rebut the defense or claim in recoupment by proof to the contrary, in which case a verdict may be directed for either party or the issue may be for the trier of fact. Subsection (b) means only that if the plaintiff claims the rights of a holder in due course against the defense or claim in recoupment, the plaintiff has the burden of proof on that issue.

ANNOTATION

I. General Consideration.
II. Presumption of Delivery.

I. GENERAL CONSIDERATION.

Law reviews. For note, "The Burden of Proof of a Holder in Due Course of a Defective Negotiable Instrument", see 4 Rocky Mt. L. Rev. 145 (1932). For article, "One Year Review of Contracts", see 36 Dicta 19 (1959).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Every holder of a negotiable instrument is deemed prima facie to be a holder in due course. Civic Fin. Co. v. Meintzer, 137 Colo. 572, 328 P.2d 379 (1958). See Myrick v. Garcia, 138 Colo. 298, 332 P.2d 900 (1958).

A holder is entitled to sue thereon. A holder of a promissory note is deemed prima facie to be a holder in due course and entitled to sue thereon. Waterman v. Sullivan, 156 Colo. 195, 397 P.2d 739 (1964).

A holder is entitled to recover. A plaintiff, being holder of a note in his possession, is entitled to have it admitted in evidence, establishing a prima facie right to recover thereon. Myrick v. Garcia, 138 Colo. 298, 332 P.2d 900 (1958).

Whether a promissory note is negotiable or not is immaterial, as the same result would obtain, a holder of an instrument being entitled to sue thereon as the prima facie owner. Myrick v. Garcia, 138 Colo. 298, 332 P.2d 900 (1958).

Assignee of negotiable instrument suing thereon need not plead specific facts from which his assignor derives the status of a holder in due course. Blake v. Samuelson, 34 Colo. App. 183, 524 P.2d 624 (1974).

A holder is entitled to the presumption of due course holding until the maker succeeds in showing a defense. Atkinson v. Englewood State Bank, 141 Colo. 436, 348 P.2d 702 (1960).

Where the answer of the maker denies that the holder is the owner of the note sued upon, such answer merely has the effect of putting this defense in issue, and thus the holder is not obliged to prove such ownership until maker's evidence challenges his prima facie title. Myrick v. Garcia, 138 Colo. 298, 332 P.2d 900 (1958), rev'g in part Marks v. Munson, 59 Colo. 440, 149 P. 440 (1915); Middlesex Safe Deposit & Trust Co. v. Jacobs, 87 Colo. 445, 290 P. 784 (1930).

The burden of establishing an affirmative defense against a holder in due course is on the maker. Atkinson v. Englewood State Bank, 141 Colo. 436, 348 P.2d 702 (1960) (fraud).

The burden is on the holder. When it is shown that the title of any person who has negotiated a promissory note is defective, the burden is on the holder to prove that he, or some person under whom he claims, acquired the title as a holder in due course. Delaney v. Brownwood, 73 Colo. 83, 213 P. 578 (1923). See McClellan v. Morris, 71 Colo. 304, 206 P. 575 (1922); Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954).

By a preponderance of the evidence. Where the maker proves at least a prima facie defense, the burden is on the holder to establish by a preponderance of the evidence that he is a holder in due course. Atkinson v. Englewood State Bank, 141 Colo. 436, 348 P.2d 702 (1960).

That he is a bona fide holder. Where title is defective the burden of proof is upon the holder to show that he is a bona fide holder and that he took the paper before maturity, in good faith and for value. Johnson County Sav. Bank v. Gregg, 51 Colo. 358, 117 P. 1003 (1911).

Which may be sustained by proof of paying full value and good faith. Where the burden of showing due course is cast upon the holder, he sustains that burden by proof of payment of full value and by showing the full details of the transaction from which there can be no national inference of knowledge or bad faith on his part. Delaney v. Brownwood, 73 Colo. 83, 213 P. 578 (1923); Omaha Steel Works v. Martin, 78 Colo. 560, 243 P. 619 (1926).

Upon proof of full payment, a presumption of innocence prevails again as before the proof of defective title, subject, of course, to refutation by further evidence. This rule is reasonable, for who, with knowledge that a note was paid or invalid, would buy it at full price? Delaney v. Brownwood, 73 Colo. 83, 213 P. 578 (1923).

Evidence held to support finding that holder purchased note in due course. Stewart v. Pub. Indus. Bank, 85 Colo. 546, 277 P. 782 (1929).

Section determinative of sufficiency of allegations required to state claim. Although this statute on its face is concerned with evidentiary burdens of proof, it is also determinative of the sufficiency of allegations required to state a claim for relief in an action to recover on a negotiable instrument. Blake v. Samuelson, 34 Colo. App. 183, 524 P.2d 624 (1974).

Subsection (2) sets forth the requirements of a prima facie case. Blake v. Samuelson, 34 Colo. App. 183, 524 P.2d 624 (1974).

Parol evidence to show that a maker was only secondarily liable on a note is not a defense under subsection (2) and rejection of such evidence was not error. Metro Nat'l Bank v. Roe, 675 P.2d 331 (Colo. App. 1983).

Applied in First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

II. PRESUMPTION OF DELIVERY.

Under the N.I.L., as long as an instrument remained in the possession of a person whose signature appeared thereon, there was no presumption of delivery from that person. Norman v. McCarthy, 56 Colo. 290, 138 P. 28 (1914).

When the instrument was no longer in the possession of a party whose signature appeared thereon, a delivery from the persons whose signatures did appear thereon was presumed until the contrary appeared. Norman v. McCarthy, 56 Colo. 290, 138 P. 28 (1914). See Weaver v. First Nat'l Bank, 138 Colo. 83, 330 P.2d 142 (1958).

When the instrument was in the possession of a holder in due course, that presumption became conclusive. Norman v. McCarthy, 56 Colo. 290, 138 P. 28 (1914).

Where there was no evidence of the delivery, it was presumed that it was delivered to the named payee by the drawer. Weaver v. First Nat'l Bank, 138 Colo. 83, 330 P.2d 142 (1958).

Indorsement allegation implied delivery. In an action upon a negotiable promissory note by an indorsee, an allegation that the payee indorsed the note to the indorsee implied a delivery, and it was unnecessary to specifically allege a delivery. Louisville Coal Mining Co. v. Int'l. Trust Co., 18 Colo. App. 345, 71 P. 898 (1903).

Presumption of delivery did not apply where fiduciary relationship. The general presumption of delivery was overcome by the specific presumption arising where there was a fiduciary relationship in which case the claimant had to overcome, by evidence, the presumption of undue influence with which the transaction was tainted because of the existence of the fiduciary relationship. Arnold v. Abernethy, 134 Colo. 573, 307 P.2d 1106 (1957).

4-3-309. Enforcement of lost, destroyed, or stolen instrument. (a) A person not in possession of an instrument is entitled to enforce the instrument if (i) the person was in possession of the instrument and entitled to enforce it when loss of possession occurred, (ii) the loss of possession was not the result of a transfer by the person or a lawful seizure, and (iii) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(b) A person seeking enforcement of an instrument under subsection (a) of this section must prove the terms of the instrument and the person's right to enforce the instrument. If that proof is made, section 4-3-308 applies to the case as if the person seeking enforcement

had produced the instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.

Source: L. 94: Entire article R&RE, p. 858, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-804 as it existed prior to 1994.

OFFICIAL COMMENT

Section 3-309 is a modification of former Section 3-804. The rights stated are those of "a person entitled to enforce the instrument" at the time of loss rather than those of an "owner" as in former Section 3-804. Under subsection (b), judgment to enforce the instrument cannot be given unless the court finds that the defendant will be adequately protected against a claim to the instrument by a holder that may appear at some later time. The court is given discretion in determining how adequate protection is to be assured. Former Section 3-804 allowed the court to "require security indemnifying the defendant against loss." Under Section 3-309 adequate protection is a flexible concept. For example, there is substantial risk that a holder in due course may make a demand for payment if the instrument was payable to bearer when it was lost or stolen. On the other hand if the instrument was payable to the person who lost the instrument and that person did not indorse the instrument, no other person could be a holder of the instrument. In some cases there is risk of loss only if there is doubt about whether the facts alleged by the person who lost the instrument are true. Thus, the type of adequate protection that is reasonable in the circumstances may depend on the degree of certainty about the facts in the case.

ANNOTATION

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974).

Applied in Hull v. Bowest Corp., 649 P.2d 334 (Colo. App. 1982), aff'd, 683 P.2d 1181 (Colo. 1984).

4-3-310. Effect of instrument on obligation for which taken. (a) Unless otherwise agreed, if a certified check, cashier's check, or teller's check is taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation. Discharge of the obligation does not affect any liability that the obligor may have as an indorser of the instrument.

(b) Unless otherwise agreed and except as provided in subsection (a) of this section, if a note or an uncertified check is taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken, and the following rules apply:

(1) In the case of an uncertified check, suspension of the obligation continues until dishonor of the check or until it is paid or certified. Payment or certification of the check results in discharge of the obligation to the extent of the amount of the check.

(2) In the case of a note, suspension of the obligation continues until dishonor of the note or until it is paid. Payment of the note results in discharge of the obligation to the extent of the payment.

(3) Except as provided in paragraph (4) of this subsection (b), if the check or note is dishonored and the obligee of the obligation for which the instrument was taken is the person entitled to enforce the instrument, the obligee may enforce either the instrument or the obligation. In the case of an instrument of a third person which is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation.

(4) If the person entitled to enforce the instrument taken for an obligation is a person other than the obligee, the obligee may not enforce the obligation to the extent the

obligation is suspended. If the obligee is the person entitled to enforce the instrument but no longer has possession of it because it was lost, stolen, or destroyed, the obligation may not be enforced to the extent of the amount payable on the instrument, and to that extent the obligee's rights against the obligor are limited to enforcement of the instrument.

(c) If an instrument other than one described in subsection (a) or (b) of this section is taken for an obligation, the effect is (i) that stated in subsection (a) of this section if the instrument is one on which a bank is liable as maker or acceptor, or (ii) that stated in subsection (b) of this section in any other case.

Source: L. 94: Entire article R&RE, p. 859, § 1, effective January 1, 1995.

OFFICIAL COMMENT

1. Section 3-310 is a modification of former Section 3-802. As a practical matter, application of former Section 3-802 was limited to cases in which a check or a note was given for an obligation. Subsections (a) and (b) of Section 3-310 are therefore stated in terms of checks and notes in the interests of clarity. Subsection (c) covers the rare cases in which some other instrument is given to pay an obligation.

2. Subsection (a) deals with the case in which a certified check, cashier's check or teller's check is given in payment of an obligation. In that case the obligation is discharged unless there is an agreement to the contrary. Subsection (a) drops the exception in former Section 3-802 for cases in which there is a right of recourse on the instrument against the obligor. Under former Section 3-802(1)(a) the obligation was not discharged if there was a right of recourse on the instrument against the obligor. Subsection (a) changes this result. The underlying obligation is discharged, but any right of recourse on the instrument is preserved.

3. Subsection (b) concerns cases in which an uncertified check or a note is taken for an obligation. The typical case is that in which a buyer pays for goods or services by giving the seller the buyer's personal check, or in which the buyer signs a note for the purchase price. Subsection (b) also applies to the uncommon cases in which a check or note of a third person is given in payment of the obligation. Subsection (b) preserves the rule under former Section 3-802(1)(b) that the buyer's obligation to pay the price is suspended, but subsection (b) spells out the effect more precisely. If the check or note is dishonored, the seller may sue on either the dishonored instrument or the contract of sale if the seller has possession of the instrument and is the person entitled to enforce it. If the right to enforce the instrument is held by somebody other than the seller, the seller can't enforce the right to payment of the price under the sales contract because that right is represented by the instrument which is enforceable by somebody else. Thus, if the seller sold the note or the check to a holder and has not reacquired it after dishonor, the only right that survives is the right to enforce the instrument.

The last sentence of subsection (b)(3) applies to cases in which an instrument of another person is indorsed over to the obligee in payment of the obligation. For example, Buyer delivers an uncertified personal check of X payable to the order of Buyer to Seller in payment of the price of goods. Buyer indorses the check over to Seller. Buyer is liable on the check as indorser. If Seller neglects to present the check for payment or to deposit it for collection within 30 days of the indorsement, Buyer's liability as indorser is discharged. Section 3-415(e). Under the last sentence of Section 3-310(b)(3) Buyer is also discharged on the obligation to pay for the goods.

4. There was uncertainty concerning the applicability of former Section 3-802 to the case in which the check given for the obligation was stolen from the payee, the payee's signature was forged, and the forger obtained payment. The last sentence of subsection (b)(4) addresses this issue. If the payor bank pays a holder, the drawer is discharged on the underlying obligation because the check was paid. Subsection (b)(1). If the payor bank pays a person not entitled to enforce the instrument, as in the hypothetical case, the suspension of the underlying obligation continues because the check has not been paid. Section 3-602(a). The payee's cause of action is against the depositary bank or payor bank in conversion under Section 3-420 or against the drawer under Section 3-309. In the latter case, the drawer's obligation under Section 3-414(b) is triggered by dishonor which occurs because the check is unpaid. Presentment for payment to the drawee is excused under Section 3-504(a)(i) and, under Section 3-502(e), dishonor occurs without presentment if the check is not paid. The payee cannot merely ignore the instrument and sue the drawer on the underlying contract. This would impose on the drawer the risk that the check when stolen was indorsed in blank or to bearer.

A similar analysis applies with respect to lost instruments that have not been paid. If a creditor takes a check of the debtor in payment of an obligation, the obligation is suspended under the introductory paragraph of subsection (b). If the

creditor then loses the check, what are the creditor's rights? The creditor can request the debtor to issue a new check and in many cases, the debtor will issue a replacement check after stopping payment on the lost check. In that case both the debtor and creditor are protected. But the debtor is not obliged to issue a new check. If the debtor refuses to issue a replacement check, the last sentence of subsection (b)(4) applies. The creditor may not enforce the obligation of debtor for which the check was taken. The creditor may assert only rights on the check. The creditor can proceed under Section 3-309 to enforce the obligation of the debtor, as drawer, to pay the check.

5. Subsection (c) deals with rare cases in which other instruments are taken for obligations. If a bank is the obligor on the instrument, subsection (a) applies and the obligation is discharged. In any other case subsection (b) applies.

ANNOTATION

Payment by cashier's check, certified funds, or certified check on debtor's account was "taken" for obligation under subsection (a) without regard to bank's internal administrative actions after receipt of payment. Fifth Third Bank v. Jones, 168 P.3d 1 (Colo. App. 2007).

Maker of check not exposed to double liability where he was required to pay the holder since, upon payment of the checks, its liability is completely discharged. Once the obligor is discharged on the instruments, he is also discharged on the underlying obligation. Lamson v. Commercial Credit Corp., 187 Colo. 382, 531 P.2d 966 (1975).

Rule that negotiable instrument constitutes conditional payment is subject to condition "unless otherwise agreed" is applied in Berardini v. Hart, 682 P.2d 519 (Colo. App. 1984).

Applied in Mountain Stone Co. v. H.W. Hammond Co., 39 Colo. App. 58, 564 P.2d 958 (1977).

4-3-311. Accord and satisfaction by use of instrument. (a) If a person against whom a claim is asserted proves that (i) that person in good faith tendered an instrument to the claimant as full satisfaction of the claim, (ii) the amount of the claim was unliquidated or subject to a bona fide dispute, and (iii) the claimant obtained payment of the instrument, the following subsections apply.

(b) Unless subsection (c) of this section applies, the claim is discharged if the person against whom the claim is asserted proves that the instrument or an accompanying written communication contained a conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim.

(c) Subject to subsection (d) of this section, a claim is not discharged under subsection (b) of this section if either of the following applies:

(1) The claimant, if an organization, proves that (i) within a reasonable time before the tender, the claimant sent a conspicuous statement to the person against whom the claim is asserted that communications concerning disputed debts, including an instrument tendered as full satisfaction of a debt, are to be sent to a designated person, office, or place, and (ii) the instrument or accompanying communication was not received by that designated person, office, or place.

(2) The claimant, whether or not an organization, proves that within ninety days after payment of the instrument, the claimant tendered repayment of the amount of the instrument to the person against whom the claim is asserted. This paragraph (2) does not apply if the claimant is an organization that sent a statement complying with paragraph (1) (i) of this subsection (c).

(d) A claim is discharged if the person against whom the claim is asserted proves that within a reasonable time before collection of the instrument was initiated, the claimant, or an agent of the claimant having direct responsibility with respect to the disputed obligation, knew that the instrument was tendered in full satisfaction of the claim.

Source: L. 94: Entire article R&RE, p. 859, § 1, effective January 1, 1995.

OFFICIAL COMMENT

1. This section deals with an informal method of dispute resolution carried out by use of a negotiable instrument. In the typical case there is a dispute concerning the amount that is owed on a claim.

Case #1. The claim is for the price of goods or services sold to a consumer who asserts that he or she is not obliged to pay the full price for which the consumer was billed because of a defect or breach of warranty with respect to the goods or services.

Case #2. A claim is made on an insurance policy. The insurance company alleges that it is not liable under the policy for the amount of the claim.

In either case the person against whom the claim is asserted may attempt an accord and satisfaction of the disputed claim by tendering a check to the claimant for some amount less than the full amount claimed by the claimant. A statement will be included on the check or in a communication accompanying the check to the effect that the check is offered as full payment or full satisfaction of the claim. Frequently, there is also a statement to the effect that obtaining payment of the check is an agreement by the claimant to a settlement of the dispute for the amount tendered. Before enactment of revised Article 3, the case law was in conflict over the question of whether obtaining payment of the check had the effect of an agreement to the settlement proposed by the debtor. This issue was governed by a common law rule, but some courts hold that the common law was modified by former Section 1-207 which they interpreted as applying to full settlement checks.

2. Comment d. to Restatement of Contracts, Section 281 discusses the full satisfaction check and the applicable common law rule. In a case like Case #1, the buyer can propose a settlement of the disputed bill by a clear notation on the check indicating that the check is tendered as full satisfaction of the bill. Under the common law rule the seller, by obtaining payment of the check accepts the offer of compromise by the buyer. The result is the same if the seller adds a notation to the check indicating that the check is accepted under protest or in only partial satisfaction of the claim. Under the common law rule the seller can refuse the check or can accept it subject to the condition stated by the buyer, but the seller can't accept the check and refuse to be bound by the condition. The rule applies only to an unliquidated claim or a claim disputed in good faith by the buyer. The dispute in the courts was whether Section 1-207 changed the common law rule. The Restatement states that section "need not be read as changing this well-established rule."

3. As part of the revision of Article 3, Section 1-207 has been amended to add subsection (2) stating that Section 1-207 "does not apply to an accord and satisfaction." Because of that amendment and revised Article 3, Section 3-311 governs full satisfaction checks. Section 3-311 follows the common law rule with some minor variations to reflect modern business conditions. In cases covered by Section 3-311 there will often be an individual on one side of the dispute and a business organization on the other. This section is not designed to favor either the individual or the business organization. In Case #1 the person seeking the accord and satisfaction is an individual. In Case #2 the person seeking the accord and satisfaction is an insurance company. Section 3-311 is based on a belief that the common law rule produces a fair result and that informal dispute resolution by full satisfaction checks should be encouraged.

4. Subsection (a) states three requirements for application of Section 3-311. "Good faith" in subsection (a)(i) is defined in Section 3-103(a)(4) as not only honesty in fact, but the observance of reasonable commercial standards of fair dealing. The meaning of "fair dealing" will depend upon the facts in the particular case. For example, suppose an insurer tenders a check in settlement of a claim for personal injury in an accident clearly covered by the insurance policy. The claimant is necessitous and the amount of the check is very small in relationship to the extent of the injury and the amount recoverable under the policy. If the trier of fact determines that the insurer was taking unfair advantage of the claimant, an accord and satisfaction would not result from payment of the check because of the absence of good faith by the insurer in making the tender. Another example of lack of good faith is found in the practice of some business debtors in routinely printing full satisfaction language on their check stocks so that all or a large part of the debts of the debtor are paid by checks bearing the full satisfaction language, whether or not there is any dispute with the creditor. Under such a practice the claimant cannot be sure whether a tender in full satisfaction is or is not being made. Use of a check on which full satisfaction language was affixed routinely pursuant to such a business practice may prevent an accord and satisfaction on the ground that the check was not tendered in good faith under subsection (a)(i).

Section 3-311 does not apply to cases in which the debt is a liquidated amount and not subject to a bona fide dispute. Subsection (a)(ii). Other law applies to cases in which a debtor is seeking discharge of such a debt by paying less than the amount owed. For the purpose of subsection (a)(iii) obtaining acceptance of a check is considered to be obtaining payment of the check.

The person seeking the accord and satisfaction must prove that the requirements of subsection (a) are met. If that person also proves that the statement required by subsection (b) was given, the claim is discharged unless subsection (c) applies. Normally the statement required by subsection (b) is written on the check. Thus, the canceled check can be used to prove the statement as well as the fact that the claimant obtained payment of the check. Subsection (b) requires a "conspicuous" statement that the instrument was tendered in full satisfaction of the claim. "Conspicuous" is defined in Section 1-201(10). The statement is conspicuous if "it is so written that a reasonable person against whom it is to operate ought to have noticed it." If the claimant can reasonably be expected to examine the check, almost any statement on the check should be noticed and is therefore conspicuous. In cases in which the claimant is an individual the claimant will receive the check and will normally indorse it. Since the statement concerning tender in full satisfaction normally will appear above the space provided for the claimant's indorsement of the check, the claimant "ought to have noticed" the statement.

5. Subsection (c)(1) is a limitation on subsection (b) in cases in which the claimant is an organization. It is designed to protect the claimant against inadvertent accord and satisfaction. If the claimant is an organization payment of the check might be obtained without notice to the personnel of the organization concerned with the disputed claim. Some business organizations have claims against very large numbers of customers. Examples are department stores, public utilities and the like. These claims are normally paid by checks sent by customers to a designated office at which clerks employed by the claimant or a bank acting for the claimant process the checks and record the amounts paid. If the processing office is not designed to deal with communications extraneous to recording the amount of the check and the account number of the customer, payment of a full satisfaction check can easily be obtained without knowledge by the claimant of the existence of the full satisfaction statement. This is particularly true if the statement is written on the reverse side of the check in the area in which indorsements are usually written. Normally, the clerks of the claimant have no reason to look at the reverse side of checks. Indorsement by the claimant normally is done by mechanical means or there may be no indorsement at all. Section 4-205(a). Subsection (c)(1) allows the claimant to protect itself by advising customers by a conspicuous statement that communications regarding disputed debts must be sent to a particular person, office, or place. The statement must be given to the customer within a reasonable time before the tender is made. This requirement is designed to assure that the customer has reasonable notice that the full satisfaction check must be sent to a particular place. The reasonable time requirement could be satisfied by a notice on the billing statement sent to the customer. If the full satisfaction check is sent to the designated destination and the check is paid, the claim is discharged. If the claimant proves that the check was not received at the designated destination the claim is not discharged unless subsection (d) applies.

6. Subsection (c)(2) is also designed to prevent inadvertent accord and satisfaction. It can be used by a claimant other than an organization or by a claimant as an alternative to subsection (c)(1). Some organizations may be reluctant to use subsection (c)(1) because it may result in confusion of customers that causes checks to be routinely sent to the special designated person, office, or place. Thus, much of the benefit of rapid processing of checks may be lost. An organization that chooses not to send a notice complying with subsection (c)(1)(i) may prevent an inadvertent accord and satisfaction by complying with subsection (c)(2). If the claimant discovers that it has obtained payment of a full satisfaction check, it may prevent an accord and satisfaction if, within 90 days of the payment of the check, the claimant tenders repayment of the amount of the check to the person against whom the claim is asserted.

7. Subsection (c) is subject to subsection (d). If a person against whom a claim is asserted proves that the claimant obtained payment of a check known to have been tendered in full satisfaction of the claim by "the claimant or an agent of the claimant having direct responsibility with respect to the disputed obligation," the claim is discharged even if (i) the check was not sent to the person, office, or place required by a notice complying with subsection (c)(1), or (ii) the claimant tendered repayment of the amount of the check in compliance with subsection (c)(2).

A claimant knows that a check was tendered in full satisfaction of a claim when the claimant "has actual knowledge" of that fact. Section 1-201(25). Under Section 1-201(27), if the claimant is an organization, it has knowledge that a check was tendered in full satisfaction of the claim when that fact is "brought to the attention of the individual conducting that transaction, and in any event when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transac-

tion would be materially affected by the information."

With respect to an attempted accord and satisfaction the "individual conducting that transaction" is an employee or other agent of the organization having direct responsibility with respect to the dispute. For example, if the check and communication are received by a collection agency acting for the claimant to collect the disputed claim, obtaining payment of the check will result in an accord and satisfaction even if the claimant gave notice, pursuant to subsection (c)(1), that full satisfaction checks be sent to some other office. Similarly, if a customer asserting a claim for breach of warranty with respect to defective goods purchased in a retail outlet of a large chain store delivers the full satisfaction check to the manager of the retail outlet at which the goods were purchased, obtaining payment of the check will also result in an accord and satisfaction. On the other hand, if the check is mailed to the chief executive officer of the chain store subsection (d) would probably not be satisfied. The chief executive officer of a large corporation may have general responsibility for operations of the company, but does not normally have direct responsibility for resolving a small disputed bill to a customer. A check for a relatively small amount mailed to a high executive officer of a large organization is not likely to receive the executive's personal attention. Rather, the check would normally be routinely sent to the appropriate office for deposit and credit to the customer's account. If the check does receive the personal attention of the high executive officer and the officer is aware of the full-satisfaction language, collection of the check will result in an accord and satisfaction because subsection (d) applies. In this case the officer has assumed direct responsibility with respect to the disputed transaction.

If a full satisfaction check is sent to a lock box or other office processing checks sent to the claimant, it is irrelevant whether the clerk processing the check did or did not see the statement that the check was tendered as full satisfaction of the claim. Knowledge of the clerk is not imputed to the organization because the clerk has no responsibility with respect to an accord and satisfaction. Moreover, there is no failure of "due diligence" under Section 1-201(27) if the claimant does not require its clerks to look for full satisfaction statements on checks or accompanying communications. Nor is there any duty of the claimant to assign that duty to its clerks. Section 3-311(c) is intended to allow a claimant to avoid an inadvertent accord and satisfaction by complying with either subsection (c)(1) or (2) without burdening the check-processing operation with extraneous and wasteful additional duties.

8. In some cases the disputed claim may have been assigned to a finance company or bank as part of a financing arrangement with respect to accounts receivable. If the account debtor was notified of the assignment, the claimant is the assignee of the account receivable and the "agent of the claimant" in subsection (d) refers to an agent of the assignee.

ANNOTATION

Law reviews. For article, "Full Satisfaction Checks Under UCC Revised Article III", see 24 Colo. Law. 771 (1995).

4-3-312. Lost, destroyed, or stolen cashier's check, teller's check, or certified check. (a) In this section:

(1) "Check" means a cashier's check, teller's check, or certified check.

(2) "Claimant" means a person who claims the right to receive the amount of a cashier's check, teller's check, or certified check that was lost, destroyed, or stolen.

(3) "Declaration of loss" means a written statement, made under penalty of perjury, to the effect that (i) the declarer lost possession of a check, (ii) the declarer is the drawer or payee of the check, in the case of a certified check, or the remitter or payee of the check, in the case of a cashier's check or teller's check, (iii) the loss of possession was not the result of a transfer by the declarer or a lawful seizure, and (iv) the declarer cannot reasonably obtain possession of the check because the check was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(4) "Obligated bank" means the issuer of a cashier's check or teller's check or the acceptor of a certified check.

(b) A claimant may assert a claim to the amount of a check by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check, if (i) the claimant is the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check, (ii) the communication contains

or is accompanied by a declaration of loss of the claimant with respect to the check, (iii) the communication is received at a time and in a manner affording the bank a reasonable time to act on it before the check is paid, and (iv) the claimant provides reasonable identification if requested by the obligated bank. Delivery of a declaration of loss is a warranty of the truth of the statements made in the declaration. The warranty is made to the obligated bank and any person entitled to enforce the check. If a claim is asserted in compliance with this subsection (b), the following rules apply:

(1) The claim becomes enforceable at the later of (i) the time the claim is asserted, or (ii) the 90th day following the date of the check, in the case of a cashier's check or teller's check, or (iii) the 90th day following the date of the acceptance, in the case of a certified check.

(2) Until the claim becomes enforceable, it has no legal effect and the obligated bank may pay the check or, in the case of a teller's check, may permit the drawee to pay the check. Payment to person entitled to enforce the check discharges all liability of the obligated bank with respect to the check.

(3) If the claim becomes enforceable before the check is presented for payment, the obligated bank is not obliged to pay the check.

(4) When the claim becomes enforceable, the obligated bank becomes obliged to pay the amount of the check to the claimant if payment of the check has not been made to a person entitled to enforce the check. Subject to section 4-4-302 (a) (1), payment to the claimant discharges all liability of the obligated bank with respect to the check.

(c) If the obligated bank pays the amount of a check to a claimant under subsection (b) (4) of this section and, after the claim became enforceable, the check is presented for payment by a person having rights of a holder in due course, the claimant is obliged to (i) refund the payment to the obligated bank if the check is paid, or (ii) pay the amount of the check to the person having rights of a holder in due course if the check is dishonored.

(d) If a claimant has the right to assert a claim under subsection (b) of this section and is also a person entitled to enforce a cashier's check, teller's check, or certified check which is lost, destroyed, or stolen, the claimant may assert rights with respect to the check either under this section or section 4-3-309.

Source: L. 94: Entire article R&RE, p. 860, § 1, effective January 1, 1995.

OFFICIAL COMMENT

1. This section applies to cases in which a cashier's check, teller's check, or certified check is lost, destroyed, or stolen. In one typical case a customer of a bank closes his or her account and takes a cashier's check or teller's check of the bank as payment of the amount of the account. The customer may be moving to a new area and the check is to be used to open a bank account in that area. In such a case the check will normally be payable to the customer. In another typical case a cashier's check or teller's check is bought from a bank for the purpose of paying some obligation of the buyer of the check. In such a case the check may be made payable to the customer and then negotiated to the creditor by indorsement. But often, the payee of the check is the creditor. In the latter case the customer is a remitter. The section covers loss of the check by either the remitter or the payee. The section also covers loss of a certified check by either the drawer or payee.

Under Section 3-309 a person seeking to enforce a lost, destroyed, or stolen cashier's check or teller's check may be required by the court to give adequate protection to the issuing bank against loss that might occur by reason of the claim by another person to enforce the check. This might require the posting of an expensive bond for the amount of the check. Moreover, Section 3-309 applies only to a person entitled to enforce the check. It does not apply to a remitter of a cashier's check or teller's check or to the drawer of a certified check. Section 3-312 applies to both. The purpose of Section 3-312 is to offer a person who loses such a check a means of getting refund of the amount of the check within a reasonable period of time without the expense of posting a bond and with full protection of the obligated bank.

2. A claim to the amount of a lost, destroyed, or stolen cashier's check, teller's check, or certified check may be made under subsection (b) if the following requirements of that subsection are met. First, a claim may be asserted only by the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check. An indorsee of a check is not covered because the indorsee is not an original party to

the check or a remitter. Limitation to an original party or remitter gives the obligated bank the ability to determine, at the time it becomes obligated on the check, the identity of the person or persons who can assert a claim with respect to the check. The bank is not faced with having to determine the rights of some person who was not a party to the check at that time or with whom the bank had not dealt. If a cashier's check is issued to the order of the person who purchased it from the bank and that person indorses it over to a third person who loses the check, the third person may assert rights to enforce the check under Section 3-309 but has no rights under Section 3-312.

Second, the claim must be asserted by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check. "Obligated bank" is defined in subsection (a)(4). Third, the communication must be received in time to allow the obligated bank to act on the claim before the check is paid, and the claimant must provide reasonable identification if requested. Subsections (b)(iii) and (iv). Fourth, the communication must contain or be accompanied by a declaration of loss described in subsection (b). This declaration is an affidavit or other writing made under penalty of perjury alleging the loss, destruction, or theft of the check and stating that the declarer is a person entitled to assert a claim, i.e. the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check.

A claimant who delivers a declaration of loss makes a warranty of the truth of the statements made in the declaration. The warranty is made to the obligated bank and anybody who has a right to enforce the check. If the declaration of loss falsely alleges loss of a cashier's check that did not in fact occur, a holder of the check who was unable to obtain payment because subsection (b)(3) and (4) caused the obligated bank to dishonor the check would have a cause of action against the declarer for breach of warranty.

The obligated bank may not impose additional requirements on the claimant to assert a claim under subsection (b). For example, the obligated bank may not require the posting of a bond or other form of security. Section 3-312(b) states the procedure for asserting claims covered by the section. Thus, procedures that may be stated in other law for stating claims to property do not apply and are displaced within the meaning of Section 1-103.

3. A claim asserted under subsection (b) does not have any legal effect, however, until the date it becomes enforceable, which cannot be earlier than 90 days after the date of a cashier's check or teller's check or 90 days after the date of acceptance of a certified check. Thus, if a lost check is presented for payment within the 90-day period, the bank may pay a person entitled to enforce the check without regard to the claim and is discharged of all liability with respect to the check. This ensures the continued utility of cashier's checks, teller's checks, and certified checks as cash equivalents. Virtually all such checks are presented for payment within 90 days.

If the claim becomes enforceable and payment has not been made to a person entitled to enforce the check, the bank becomes obligated to pay the amount of the check to the claimant. Subsection (b)(4). When the bank becomes obligated to pay the amount of the check to the claimant, the bank is relieved of its obligation to pay the check. Subsection (b)(3). Thus, any person entitled to enforce the check, including even a holder in due course, loses the right to enforce the check after a claim under subsection (b) becomes enforceable.

If the obligated bank pays the claimant under subsection (b)(4), the bank is discharged of all liability with respect to the check. The only exception is the unlikely case in which the obligated bank subsequently incurs liability under Section 4-302 (a)(1) with respect to the check. For example, Obligated Bank is the issuer of a cashier's check and, after a claim becomes enforceable, it pays the claimant under subsection (b)(4). Later the check is presented to Obligated Bank for payment over the counter. Under subsection (b)(3), Obligated Bank is not obliged to pay the check and may dishonor the check by returning it to the person who presented it for payment. But the normal rules of check collection are not affected by Section 3-312. If Obligated Bank retains the check beyond midnight of the day of presentment without settling for it, it becomes accountable for the amount of the check under Section 4-302 (a)(1) even though it had no obligation to pay the check.

An obligated bank that pays the amount of a check to a claimant under subsection (b)(4) is discharged of all liability on the check so long as the assertion of the claim meets the requirements of subsection (b) discussed in Comment 2. This is important in cases of fraudulent declarations of loss. For example, if the claimant falsely alleges a loss that in fact did not occur, the bank, subject to Section 1-203, may rely on the declaration of loss. On the other hand, a claim may be asserted only by a person described in subsection (b)(i). Thus, the bank is discharged under subsection (a)(4) only if it pays such a person. Although it is highly unlikely, it is possible that more than one person could assert a claim under subsection (b) to the amount of a check. Such a case could occur if one of the claimants makes a false declaration of loss. The obligated bank is not required to determine whether a claimant who complies with subsection (b) is acting wrongfully. The bank may utilize procedures outside this Article, such

as interpleader, under which the conflicting claims may be adjudicated.

Although it is unlikely that a lost check would be presented for payment after the claimant was paid by the bank under subsection (b)(4), it is possible for it to happen. Suppose the declaration of loss by the claimant fraudulently alleged a loss that in fact did not occur. If the claimant negotiated the check, presentment for payment would occur shortly after negotiation in almost all cases. Thus, a fraudulent declaration of loss is not likely to occur unless the check is negotiated after the 90-day period has already expired or shortly before expiration. In such a case the holder of the check, who may not have noticed the date of the check, is not entitled to payment from the obligated bank if the check is presented for payment after the claim becomes enforceable. Subsection (b)(3). The remedy of the holder who is denied payment in that case is an action against the claimant under subsection (c) if the holder is a holder in due course, or for breach of warranty under subsection (b). The holder would also have common law remedies against the claimant under the law of restitution or fraud.

4. The following cases illustrate the operation of Section 3-312:

Case #1. Obligated Bank (OB) certified a check drawn by its customer, Drawer (D), payable to Payee (P). Two days after the check was certified, D lost the check and then asserted a claim pursuant to subsection (b). The check had not been presented for payment when D's claim became enforceable 90 days after the check was certified. Under subsection (b)(4), at the time D's claim became enforceable OB became obliged to pay D the amount of the check. If the check is later presented for payment, OB may refuse to pay the check and has no obligation to anyone to pay the check. Any obligation owed by D to P, for which the check was intended as payment, is unaffected because the check was never delivered to P.

Case #2. Obligated Bank (OB) issued a teller's check to Remitter (R) payable to Payee (P). R delivered the check to P in payment of an obligation. P lost the check and then asserted a claim pursuant to subsection (b). To carry out P's order, OB issued an order pursuant to Section 4-403(a) to the drawee of the teller's check to stop payment of the check effective on the 90th day after the date of the teller's check. The check was not presented for payment. On the 90th day after the date of the teller's check P's claim becomes enforceable and OB becomes obliged to pay P the amount of the check. As in Case #1, OB has no further liability with respect to the check to anyone. When R delivered the check to P, R's underlying obligation to P was discharged under Section 3-310. Thus, R suffered no loss. Since P received the amount of the check, P also suffered no loss except with respect to the delay in receiving the amount of the check.

Case #3. Obligated Bank (OB) issued a cashier's check to its customer, Payee (P). Two days after issue, the check was stolen from P who then asserted a claim pursuant to subsection (b). Ten days after issue, the check was deposited by X in an account in Depositary Bank (DB). X had found the check and forged the indorsement of P. DB promptly presented the check to OB and obtained payment on behalf of X. On the 90th day after the date of the check P's claim becomes enforceable and P is entitled to receive the amount of the check from OB. Subsection (b)(4). Although the check was presented for payment before P's claim became enforceable, OB is not discharged. Because of the forged indorsement X was not a holder and neither was DB. Thus, neither is a person entitled to enforce the check (Section 3-301) and OB is not discharged under Section 3-602(a). Thus, under subsection (b)(4), because OB did not pay a person entitled to enforce the check, OB must pay P. OB's remedy is against DB for breach of warranty under Section 4-208(a)(1). As an alternative to the remedy under Section 3-312, P could recover from DB for conversion under Section 3-420(a).

Case #4. Obligated Bank (OB) issued a cashier's check to its customer, Payee (P). P made an unrestricted blank indorsement of the check and mailed the check to P's bank for deposit to P's account. The check was never received by P's bank. When P discovered the loss, P asserted a claim pursuant to subsection (b). X found the check and deposited it in X's account in Depositary Bank (DB) after indorsing the check. DB presented the check for payment before the end of the 90-day period after its date. OB paid the check. Because of the unrestricted blank indorsement by P, X became a holder of the check. DB also became a holder. Since the check was paid before P's claim became enforceable and payment was made to a person entitled to enforce the check, OB is discharged of all liability with respect to the check. Subsection (b)(2). Thus, P is not entitled to payment from OB. Subsection (b)(4) doesn't apply.

Case #5. Obligated Bank (OB) issued a cashier's check to its customer, Payee (P). P made an unrestricted blank indorsement of the check and mailed the check to P's bank for deposit to P's account. The check was never received by P's bank. When P discovered the loss, P asserted a claim pursuant to subsection (b). At the end of the 90-day period after the date of the check, OB paid the amount of the check to P under subsection (b)(4). X then found the check and deposited it to X's account in Depositary Bank (DB). DB presented the check to OB for payment. OB is not obliged to pay the check. Subsection (b)(4). If OB dishonors the check, DB's remedy is to charge back X's account. Section 4-214(a).

Although P, as an indorser, would normally have liability to DB under Section 3-415(a) because the check was dishonored, P is released from that liability under Section 3-415(e) because collection of the check was initiated more than 30 days after the indorsement. DB has a remedy only against X. A depositary bank that takes a cashier's check that cannot be presented for payment before expiration of the 90-day period after its date is on notice that the check might not be paid because of the possibility of a claim asserted under subsection (b) which would excuse the issuer of the check from paying the check. Thus, the depositary bank cannot safely release funds with respect to the check until it has assurance that the check has been paid. DB cannot be a holder in due course of the check because it took the check when the check was overdue. Section 3-304(a)(2). Thus, DB has no action against P under subsection (c).

Case #6. Obligated Bank (OB)issued a cashier's check payable to bearer and delivered it to its customer, Remitter (R). R held the check for 90 days and then wrongfully asserted a claim to the amount of the check under subsection (b). The declaration of loss fraudulently stated that the check was lost. R received payment from OB under subsection (b)(4). R then negotiated the check to X for value. X presented the check to OB for payment. Although OB, under subsection (b)(2), was not obliged to pay the check, OB paid X by mistake. OB's teller did not notice that the check was more than 90 days old and was not aware that OB was not obliged to pay the check. If X took the check in good faith, OB may not recover from X. Section 3-418(c). OB's remedy is to recover from R for fraud or for breach of warranty in making a false declaration of loss. Subsection (b).

PART 4

LIABILITY OF PARTIES

4-3-401. Signature. (a) A person is not liable on an instrument unless (i) the person signed the instrument, or (ii) the person is represented by an agent or representative who signed the instrument and the signature is binding on the represented person under section 4-3-402.

(b) A signature may be made (i) manually or by means of a device or machine, and (ii) by the use of any name, including a trade or assumed name, or by a word, mark, or symbol executed or adopted by a person with present intention to authenticate a writing.

Source: L. 94: Entire article R&RE, p. 862, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-401 as it existed prior to 1994.

OFFICIAL COMMENT

1. Obligation on an instrument depends on a signature that is binding on the obligor. The signature may be made by the obligor personally or by an agent authorized to act for the obligor. Signature by agents is covered by Section 3-402. It is not necessary that the name of the obligor appear on the instrument, so long as there is a signature that binds the obligor. Signature includes an indorsement.

2. A signature may be handwritten, typed, printed or made in any other manner. It need not be subscribed, and may appear in the body of the instrument, as in the case of "I, John Doe, promise to pay * * *" without any other signature. It may be made by mark, or even by thumbprint. It may be made in any name, including any trade name or assumed name, however false and fictitious, which is adopted for the purpose. Parol evidence is admissible to identify the signer, and when the signer is identified the signature is effective. Indorsement in a name other than that of the indorser is governed by Section 3-204(d).

This section is not intended to affect any other law requiring a signature by mark to be witnessed, or any signature to be otherwise authenticated, or requiring any form of proof.

ANNOTATION

Law reviews. For article, "Civil Liability for Check Forgeries in Colorado", see 16 Colo. Law. 959 (1987).

No person is liable on an instrument unless his signature appears thereon. Jett v. Phillips & Associates, 439 F.2d 987 (10th Cir. 1971).

Even if a party does not sign an assumption agreement, the party may still be liable on the original obligation for which the instrument was given. Bigelow v. Nottingham, 833 P.2d 764 (Colo. App. 1991).

However, liability may arise apart from the instrument itself. A party who does not sign an assumption agreement may still be liable on the original obligation for which the instrument is given. Husband who executed promissory note and second deed of trust, but who consented by silence to subordination agreement that impaired his collateral, is still liable as a surety for the underlying obligation. Bigelow v. Nottingham, 833 P.2d 764 (Colo. App. 1992).

4-3-402. Signature by representative. (a) If a person acting, or purporting to act, as a representative signs an instrument by signing either the name of the represented person or the name of the signer, the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract. If the represented person is bound, the signature of the representative is the "authorized signature of the represented person" and the represented person is liable on the instrument, whether or not identified in the instrument.

(b) If a representative signs the name of the representative to an instrument and the signature is an authorized signature of the represented person, the following rules apply:

(1) If the form of the signature shows unambiguously that the signature is made on behalf of the represented person who is identified in the instrument, the representative is not liable on the instrument.

(2) Subject to subsection (c) of this section, if (i) the form of the signature does not show unambiguously that the signature is made in a representative capacity or (ii) the represented person is not identified in the instrument, the representative is liable on the instrument to a holder in due course that took the instrument without notice that the representative was not intended to be liable on the instrument. With respect to any other person, the representative is liable on the instrument unless the representative proves that the original parties did not intend the representative to be liable on the instrument.

(c) If a representative signs the name of the representative as drawer of a check without indication of the representative status and the check is payable from an account of the represented person who is identified on the check, the signer is not liable on the check if the signature is an authorized signature of the represented person.

Source: L. 94: Entire article R&RE, p. 862, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-103 as it existed prior to 1994.

Cross references: For unauthorized signatures, see § 4-3-403.

OFFICIAL COMMENT

1. Subsection (a) states when the represented person is bound on an instrument if the instrument is signed by a representative. If under the law of agency the represented person would be bound by the act of the representative in signing either the name of the represented person or that of the representative, the signature is the authorized signature of the represented person. Former Section 3-401(1) stated that "no person is liable on an instrument unless his signature appears thereon." This was interpreted as meaning that an undisclosed principal is not liable on an instrument. This interpretation provided an exception to ordinary agency law that binds an undisclosed principal on a simple contract.

It is questionable whether this exception was justified by the language of former Article 3 and there is no apparent policy justification for it. The exception is rejected by subsection (a) which returns to ordinary rules of agency. If P, the principal, authorized A, the agent, to borrow money on P's behalf and A signed A's name to a note without disclosing that the signature was on behalf of P, A is liable on the instrument. But if the person entitled to enforce the note can also prove that P authorized A to sign on P's behalf, why shouldn't P also be liable on the instrument? To recognize the liability of P takes nothing away from the utility of negotiable instruments. Furthermore, imposing liability on P has the merit of making it impossible to have an instrument on which nobody is liable even though it was authorized by P. That result could occur under former Section 3-401(1) if an authorized agent signed "as agent" but the note did not identify the principal. If the dispute was between the agent and the payee of the note, the

agent could escape liability on the note by proving that the agent and the payee did not intend that the agent be liable on the note when the note was issued. Former Section 3-403(2)(b). Under the prevailing interpretation of former Section 3-401(1), the principal was not liable on the note under former Section 3-401(1) because the principal's name did not appear on the note. Thus, nobody was liable on the note even though all parties knew that the note was signed by the agent on behalf of the principal. Under Section 3-402(a) the principal would be liable on the note.

2. Subsection (b) concerns the question of when an agent who signs an instrument on behalf of a principal is bound on the instrument. The approach followed by former Section 3-403 was to specify the form of signature that imposed or avoided liability. This approach was unsatisfactory. There are many ways in which there can be ambiguity about a signature. It is better to state a general rule. Subsection (b)(1) states that if the form of the signature unambiguously shows that it is made on behalf of an identified represented person (for example, "P, by A, Treasurer") the agent is not liable. This is a workable standard for a court to apply. Subsection (b)(2) partly changes former Section 3-403(2). Subsection (b)(2) relates to cases in which the agent signs on behalf of a principal but the form of the signature does not fall within subsection (b)(1). The following cases are illustrative. In each case John Doe is the authorized agent of Richard Roe and John Doe signs a note on behalf of Richard Roe. In each case the intention of the original parties to the instrument is that Roe is to be liable on the instrument but Doe is not to be liable.

Case #1. Doe signs "John Doe" without indicating in the note that Doe is signing as agent. The note does not identify Richard Roe as the represented person.

Case #2. Doe signs "John Doe, Agent" but the note does not identify Richard Roe as the represented person.

Case #3. The name "Richard Roe" is written on the note and immediately below that name Doe signs "John Doe" without indicating that Doe signed as agent.

In each case Doe is liable on the instrument to a holder in due course without notice that Doe was not intended to be liable. In none of the cases does Doe's signature unambiguously show that Doe was signing as agent for an identified principal. A holder in due course should be able to resolve any ambiguity against Doe.

But the situation is different if a holder in due course is not involved. In each case Roe is liable on the note. Subsection (a). If the original parties to the note did not intend that Doe also be liable, imposing liability on Doe is a windfall to the person enforcing the note. Under subsection (b)(2) Doe is prima facie liable because his signature appears on the note and the form of the signature does not unambiguously refute personal liability. But Doe can escape liability by proving that the original parties did not intend that he be liable on the note. This is a change from former Section 3-403(2)(a).

A number of cases under former Article 3 involved situations in which an agent signed the agent's name to a note, without qualification and without naming the person represented, intending to bind the principal but not the agent. The agent attempted to prove that the other party had the same intention. Some of these cases involved mistake, and in some there was evidence that the agent may have been deceived into signing in that manner. In some of the cases the court refused to allow proof of the intention of the parties and imposed liability on the agent based on former Section 3-403(2)(a) even though both parties to the instrument may have intended that the agent not be liable. Subsection (b)(2) changes the result of those cases, and is consistent with Section 3-117 which allows oral or written agreements to modify or nullify apparent obligations on the instrument.

Former Section 3-403 spoke of the represented person being "named" in the instrument. Section 3-402 speaks of the represented person being "identified" in the instrument. This change in terminology is intended to reject decisions under former Section 3-403(2) requiring that the instrument state the legal name of the represented person.

3. Subsection (c) is directed at the check cases. It states that if the check identifies the represented person the agent who signs on the signature line does not have to indicate agency status. Virtually all checks used today are in personalized form which identify the person on whose account the check is drawn. In this case, nobody is deceived into thinking that the person signing the check is meant to be liable. This subsection is meant to overrule cases decided under former Article 3 such as **Griffin v. Ellinger,** 538 S.W.2d 97 (Texas 1976).

ANNOTATION

Law reviews. For article, "Augmenting the Anomalousness of the Anomalous Indorser", see 16 Dicta 254 (1939).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

The words "we promise to pay" on a note together with the signature of both a corporation and the corporation president do not impart personal liability to the corporate officer where it is clear that the signatures are intended to bind only the corporation. MacKay v. Lay, 28 Colo. App. 70, 470 P.2d 614 (1970). See New England Elec. Co. v. Shook, 27 Colo. App. 30, 145 P. 1002 (1915).

If an agent exceeds his authority, his principal may complain but a third person may not. MacKay v. Lay, 28 Colo. App. 70, 470 P.2d 614 (1970).

Indorsee may assume action of corporate officer is authorized. An indorsee before maturity and for value of a note subscribed with the name of a corporation by its principal officer who is without notice of any want of authority in such officer may assume that his action is authorized. Gold Glen Mines & Tunnel Co. v. Dennis, 21 Colo. App. 284, 121 P. 677 (1912).

If the agency of the party is made to appear, the principal will not be bound beyond the authority given. McClellan v. Morris, 71 Colo. 304, 206 P. 575 (1922).

Where corporate note is given for noncorporate debt. A promissory note of a corporation given under authority of the directors in acknowledgment of what is not a debt of the corporation and by which some of the directors become creditors of the corporation is invalid as to a payee with knowledge. Gold Glen Mining Co. v. Stimson, 44 Colo. 406, 98 P. 727 (1908).

Liability of party signing note as individual, without qualifying designation. Where parties sign a note as individuals, without any qualifying designations, they are individually liable as makers, and not as accommodation parties. Rink-A-Dinks v. TNT Motorcycles, Inc., 655 P.2d 431 (Colo. App. 1982).

Parol evidence may be admitted as between the original parties to show that one signed a note in a representative capacity. Bieser v. Irwin, 101 Colo. 210, 72 P.2d 271 (1937).

An otherwise authorized signature on a negotiable instrument is not converted into an unauthorized forgery when an agent, authorized to sign the principal's name, abuses that authority by negotiating the instrument to a holder in due course for the agent's own personal benefit. Willey v. Mayer, 876 P.2d 1260 (Colo. 1994).

Applied in Abrams v. Colo. Seal and Stripe, Inc., 702 P.2d 765 (Colo. App. 1985); La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986); Kunz v. Cycles West, Inc., 969 P.2d 781 (Colo. App. 1998).

4-3-403. Unauthorized signature. (a) Unless otherwise provided in this article or article 4 of this title, an unauthorized signature is ineffective except as the signature of the unauthorized signer in favor of a person who in good faith pays the instrument or takes it for value. An unauthorized signature may be ratified for all purposes of this article.

(b) If the signature of more than one person is required to constitute the authorized signature of an organization, the signature of the organization is unauthorized if one of the required signatures is lacking.

(c) The civil or criminal liability of a person who makes an unauthorized signature is not affected by any provision of this article which makes the unauthorized signature effective for the purposes of this article.

Source: L. 94: Entire article R&RE, p. 863, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-404 as it existed prior to 1994.

OFFICIAL COMMENT

1. "Unauthorized" signature is defined in Section 1-201(43) as one that includes a forgery as well as a signature made by one exceeding actual or apparent authority. Former Section 3-404(1) stated that an unauthorized signature was inoperative as the signature of the person whose name was signed unless that person "is precluded from denying it." Under former Section 3-406 if negligence by the person whose name was signed contributed to an unauthorized signature, that person "is precluded from asserting the * * * lack of authority." Both of these sections were applied to cases in which a forged signature appeared on an instrument and the person asserting rights on the instrument alleged that the negligence of the purported signer contributed to the forgery. Since the standards for liability between the two sections differ, the overlap between the sections caused confusion. Section 3-403(a) deals with the problem by removing the preclusion language that appeared in former Section 3-404.

2. The except clause of the first sentence of subsection (a) states the generally accepted rule that the unauthorized signature, while it is wholly inoperative as that of the person whose name is signed, is effective to impose liability upon the signer or to transfer any rights that the signer may have in the instrument. The signer's liability is not in damages for breach of warranty

of authority, but is full liability on the instrument in the capacity in which the signer signed. It is, however, limited to parties who take or pay the instrument in good faith; and one who knows that the signature is unauthorized cannot recover from the signer on the instrument.

3. The last sentence of subsection (a) allows an unauthorized signature to be ratified. Ratification is a retroactive adoption of the unauthorized signature by the person whose name is signed and may be found from conduct as well as from express statements. For example, it may be found from the retention of benefits received in the transaction with knowledge of the unauthorized signature. Although the forger is not an agent, ratification is governed by the rules and principles applicable to ratification of unauthorized acts of an agent.

Ratification is effective for all purposes of this Article. The unauthorized signature becomes valid so far as its effect as a signature is concerned. Although the ratification may relieve the signer of liability on the instrument, it does not of itself relieve the signer of liability to the person whose name is signed. It does not in any way affect the criminal law. No policy of the criminal law prevents a person whose name is forged to assume liability to others on the instrument by ratifying the forgery, but the ratification cannot affect the rights of the state. While the ratification may be taken into account with other relevant facts in determining punishment, it does not relieve the signer of criminal liability.

4. Subsection (b) clarifies the meaning of "unauthorized" in cases in which an instrument contains less than all of the signatures that are required as authority to pay a check. Judicial authority was split on the issue whether the one-year notice period under former Section 4-406(4) (now Section 4-406(f)) barred a customer's suit against a payor bank that paid a check containing less than all of the signatures required by the customer to authorize payment of the check. Some cases took the view that if a customer required that a check contain the signatures of both A and B to authorize payment and only A signed, there was no unauthorized signature within the meaning of that term in former Section 4-406(4) because A's signature was neither unauthorized nor forged. The other cases correctly pointed out that it was the customer's signature at issue and not that of A; hence, the customer's signature was unauthorized if all signatures required to authorize payment of the check were not on the check. Subsection (b) follows the latter line of cases. The same analysis applies if A forged the signature of B. Because the forgery is not effective as a signature of B, the required signature of B is lacking.

Subsection (b) refers to "the authorized signature of an organization." The definition of "organization" in Section 1-201(28) is very broad. It covers not only commercial entities but also "two or more persons having a joint or common interest." Hence subsection (b) would apply when a husband and wife are both required to sign an instrument.

ANNOTATION

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974). For article, "Commercial Law", which discusses a recent Tenth Circuit decision dealing with bank liability on forged commercial paper, see 62 Den. U. L. Rev. 84 (1985). For article, "Civil Liability for Check Forgeries in Colorado", see 16 Colo. Law. 959 (1987).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Where the officers of a corporation are given full power and authority to negotiate and execute loans for and on behalf of the corporation for its declared purpose and benefit and the corporation has benefited materially as a result of their activity, then under such circumstances, it would be wholly inequitable to permit it to be absolved of its just obligations. Security Sav. & Loan Ass'n v. Colo. Real Estate Dev., Inc., 163 Colo. 155, 429 P.2d 288 (1967).

Want of authority may not be asserted. A corporation may not give its officers "carte blanche" authority to borrow money for its authorized business purpose and then assert want of authority when the venture turns unprofitable; even if loans were not originally authorized, they are ratified by acceptance of the benefits. Security Sav. & Loan Ass'n v. Colo. Real Estate Dev., Inc., 163 Colo. 155, 429 P.2d 288 (1967).

It is error to require lender to show express authority. A court errs when it rules that the lender must show, through the corporation's articles, bylaws, or minutes, express authority for such loans from the corporation or its board, inasmuch as the application of the doctrine of estoppel has kept pace with the rapid development of corporate enterprise, so that, while ancient rules regarding limits upon powers of officers of corporations have not been abrogated, they are conclusively presumed to have been complied with or compliance to have been waived by the corporation where justice so requires. Security Sav. & Loan Ass'n v. Colo. Real

Estate Dev., Inc., 163 Colo. 155, 429 P.2d 288 (1967).

A forged or unauthorized signature of one of two joint payees destroys the negotiability of a check, and the holder of the check acquires only as an assignee of a nonnegotiable chose in action the interest of the payee who did indorse, and, as such an assignee, his interest in the proceeds of the check is to be determined. Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954); Skinner v. Mortgage Inv. Co., 165 Colo. 241, 438 P.2d 504 (1968).

A payee whose signature has been forged, or whose check has been cashed without indorsement, can treat the entire transaction as a nullity and may demand payment of the debt from the drawer of the check, his debtor. Since the check was never delivered to the payee and was not negotiated by him, it cannot be legally binding and thus the debt owed by the drawer to the payee continues outstanding. United States Portland Cement Co. v. United States Nat'l Bank, 61 Colo. 334, 157 P. 202 (1916); Denver Elec. & Neon Serv. Corp. v. Gerald H. Phipps, Inc., 143 Colo. 530, 354 P.2d 618 (1960).

A payee can sue the collecting bank directly, but the legal effect of his doing this constitutes adoption and ratification of the collection and payment of the check, notwithstanding that it was not indorsed, and the legal consequence of no indorsement is considered to be the same as a forgery for such purpose. United States Portland Cement Co. v. United States Nat'l Bank, 61 Colo. 334, 157 P. 202 (1916); Denver Elec. & Neon Serv. Corp. v. Gerald H. Phipps, Inc., 143 Colo. 530, 354 P.2d 618 (1960).

Institution of an action for conversion against bank for wrongfully paying corporate funds into the personal account of the treasurer is not a ratification of the actions of the collecting bank, but rather an election not to sue the drawee bank. Central Inc. v. Cache Nat'l Bank, 748 P.2d 351 (Colo. App. 1987).

On theory that it collected and misappropriated check proceeds. The payee of a check whose indorsement had been forged by a fraudulent agent can ratify payment by the drawee bank and maintain an action against the collecting bank on the theory that it collected and misappropriated the proceeds of the check and is thereby accountable to the payee for the proceeds. United States Portland Cement Co. v. United States Nat'l Bank. 61 Colo.; Denver Elec. & Neon Serv. Corp. v. Gerald H. Phipps, Inc., 143 Colo. 530, 354 P.2d 618 (1960). 334, 157 P. 202 (1916).

By ratifying such payment the payee releases the drawer and drawee of the check. United States Portland Cement Co. v. United States Nat'l Bank, 61 Colo. 334, 157 P. 202 (1916); Denver Elec. & Neon Serv. Corp. v. Gerald H. Phipps, Inc., 143 Colo. 530, 354 P.2d 618 (1960).

Assignee need not sue maker. In an action against indorsers of a note where one of the makers' names has been forged, an assignee is not precluded by failing to sue the makers. Cannon v. Serrel, 15 Colo. App. 99, 61 P. 187 (1900).

4-3-404. Impostors; fictitious payees. (a) If an impostor, by use of the mails or otherwise, induces the issuer of an instrument to issue the instrument to the impostor, or to a person acting in concert with the impostor, by impersonating the payee of the instrument or a person authorized to act for the payee, an indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) If (i) a person whose intent determines to whom an instrument is payable (section 4-3-110 (a) or (b)) does not intend the person identified as payee to have any interest in the instrument, or (ii) the person identified as payee of an instrument is a fictitious person, the following rules apply until the instrument is negotiated by special indorsement:

(1) Any person in possession of the instrument is its holder.

(2) An indorsement by any person in the name of the payee stated in the instrument is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(c) Under subsection (a) or (b) of this section, an indorsement is made in the name of a payee if (i) it is made in a name substantially similar to that of the payee or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to that of the payee.

(d) With respect to an instrument to which subsection (a) or (b) of this section applies, if a person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure contributes to loss resulting from payment of the instrument, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

Source: L. 94: Entire article R&RE, p. 863, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-405 as it existed prior to 1994.

OFFICIAL COMMENT

1. Under former Article 3, the impostor cases were governed by former Section 3-405(1)(a) and the fictitious payee cases were governed by Section 3-405(1)(b). Section 3-404 replaces former Section 3-405(1)(a) and (b) and modifies the previous law in some respects. Former Section 3-405 was read by some courts to require that the indorsement be in the exact name of the named payee. Revised Article 3 rejects this result. Section 3-404(c) requires only that the indorsement be made in a name "substantially similar" to that of the payee. Subsection (c) also recognizes the fact that checks may be deposited without indorsement. Section 4-205(a).

Subsection (a) changes the former law in a case in which the impostor is impersonating an agent. Under former Section 3-405(1)(a), if Impostor impersonated Smith and induced the drawer to draw a check to the order of Smith, Impostor could negotiate the check. If Impostor impersonated Smith, the president of Smith Corporation, and the check was payable to the order of Smith Corporation, the section did not apply. See the last paragraph of Comment 2 to former Section 3-405. In revised Article 3, Section 3-404(a) gives Impostor the power to negotiate the check in both cases.

2. Subsection (b) is based in part on former Section 3-405(1)(b) and in part on N.I.L. § 9(3). It covers cases in which an instrument is payable to a fictitious or nonexisting person and to cases in which the payee is a real person but the drawer or maker does not intend the payee to have any interest in the instrument. Subsection (b) applies to any instrument, but its primary importance is with respect to checks of corporations and other organizations. It also applies to forged check cases. The following cases illustrate subsection (b):

Case #1. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer fraudulently draws a check of Corporation payable to Supplier Co., a non-existent company. Subsection (b) applies because Supplier Co. is a fictitious person and because Treasurer did not intend Supplier Co. to have any interest in the check. Under subsection (b)(1) Treasurer, as the person in possession of the check, becomes the holder of the check. Treasurer indorses the check in the name "Supplier Co." and deposits it in Depositary Bank. Under subsection (b)(2) and (c)(i), the indorsement is effective to make Depositary Bank the holder and therefore a person entitled to enforce the instrument. Section 3-301.

Case #2. Same facts as Case #1 except that Supplier Co. is an actual company that does business with Corporation. If Treasurer intended to steal the check when the check was drawn, the result in Case #2 is the same as the result in Case #1. Subsection (b) applies because Treasurer did not intend Supplier Co. to have any interest in the check. It does not make any difference whether Supplier Co. was or was not a creditor of Corporation when the check was drawn. If Treasurer did not decide to steal the check until after the check was drawn, the case is covered by Section 3-405 rather than Section 3-404(b), but the result is the same. See Case #6 in Comment 3 to Section 3-405.

Case #3. Checks of Corporation must be signed by two officers. President and Treasurer both sign a check of Corporation payable to Supplier Co., a company that does business with Corporation from time to time but to which Corporation does not owe any money. Treasurer knows that no money is owed to Supplier Co. and does not intend that Supplier Co. have any interest in the check. President believes that money is owed to Supplier Co. Treasurer obtains possession of the check after it is signed. Subsection (b) applies because Treasurer is "a person whose intent determines to whom an instrument is payable" and Treasurer does not intend Supplier Co. to have any interest in the check. Treasurer becomes the holder of the check and may negotiate it by indorsing it in the name "Supplier Co."

Case #4. Checks of Corporation are signed by a check-writing machine. Names of payees of checks produced by the machine are determined by information entered into the computer that operates the machine. Thief, a person who is not an employee or other agent of Corporation, obtains access to the computer and causes the check-writing machine to produce a check payable to Supplier Co., a non-existent company. Subsection (b)(ii) applies. Thief then obtains possession of the check. At that point Thief becomes the holder of the check because Thief is the person in possession of the instrument. Subsection (b)(1). Under Section 3-301 Thief, as holder, is the "person entitled to enforce the instrument" even though Thief does not have title to the check and is in wrongful possession of it. Thief indorses the check in the name "Supplier Co." and deposits it in an account in Depositary Bank which Thief opened in the name "Supplier Co." Depositary Bank takes the check in good faith and credits the "Supplier Co." account. Under subsection (b)(2) and

(c)(i), the indorsement is effective. Depositary Bank becomes the holder and the person entitled to enforce the check. The check is presented to the drawee bank for payment and payment is made. Thief then withdraws the credit to the account. Although the check was issued without authority given by Corporation, the drawee bank is entitled to pay the check and charge Corporation's account if there was an agreement with Corporation allowing the bank to debit Corporation's account for payment of checks produced by the check-writing machine whether or not authorized. The indorsement is also effective if Supplier Co. is a real person. In that case subsection (b)(i) applies. Under Section 3-110(b) Thief is the person whose intent determines to whom the check is payable, and Thief did not intend Supplier Co. to have any interest in the check. When the drawee bank pays the check, there is no breach of warranty under Section 3-417(a)(1) or 4-208(a)(1) because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment.

Case #5. Thief, who is not an employee or agent of Corporation, steals check forms of Corporation. John Doe is president of Corporation and is authorized to sign checks on behalf of Corporation as drawer. Thief draws a check in the name of Corporation as drawer by forging the signature of Doe. Thief makes the check payable to the order of Supplier Co. with the intention of stealing it. Whether Supplier Co. is a fictitious person or a real person, Thief becomes the holder of the check and the person entitled to enforce it. The analysis is the same as that in Case #4. Thief deposits the check in an account in Depositary Bank which Thief opened in the name "Supplier Co." Thief either indorses the check in a name other than "Supplier Co." or does not indorse the check at all. Under Section 4-205(a) a depositary bank may become holder of a check deposited to the account of a customer if the customer was a holder, whether or not the customer indorses. Subsection (c)(ii) treats deposit to an account in a name substantially similar to that of the payee as the equivalent of indorsement in the name of the payee. Thus, the deposit is an effective indorsement of the check. Depositary Bank becomes the holder of the check and the person entitled to enforce the check. If the check is paid by the drawee bank, there is no breach of warranty under Section 3-417(a)(1) or 4-208(a)(1) because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment and, unless Depositary Bank knew about the forgery of Doe's signature, there is no breach of warranty under Section 3-417(a)(3) or 4-208(a)(3). Because the check was a forged check the drawee bank is not entitled to charge Corporation's account unless Section 3-406 or Section 4-406 applies.

3. In cases governed by subsection (a) the dispute will normally be between the drawer of the check that was obtained by the impostor and the drawee bank that paid it. The drawer is precluded from obtaining recredit of the drawer's account by arguing that the check was paid on a forged indorsement so long as the drawee bank acted in good faith in paying the check. Cases governed by subsection (b) are illustrated by Cases #1 through #5 in Comment 2. In Cases #1, #2, and #3 there is no forgery of the check, thus the drawer of the check takes the loss if there is no lack of good faith by the banks involved. Cases #4 and #5 are forged check cases. Depositary Bank is entitled to retain the proceeds of the check if it didn't know about the forgery. Under Section 3-418 the drawee bank is not entitled to recover from Depositary Bank on the basis of payment by mistake because Depositary Bank took the check in good faith and gave value for the check when the credit given for the check was withdrawn. And there is no breach of warranty under Section 3-417(a)(1) or (3) or 4-208(a)(1) or (3). Unless Section 3-406 applies the loss is taken by the drawee bank if a forged check is paid, and that is the result in Case #5. In Case #4 the loss is taken by Corporation, the drawer, because an agreement between Corporation and the drawee bank allowed the bank to debit Corporation's account despite the unauthorized use of the check-writing machine.

If a check payable to an impostor, fictitious payee, or payee not intended to have an interest in the check is paid, the effect of subsections (a) and (b) is to place the loss on the drawer of the check rather than on the drawee or the depositary bank that took the check for collection. Cases governed by subsection (a) always involve fraud, and fraud is almost always involved in cases governed by subsection (b). The drawer is in the best position to avoid the fraud and thus should take the loss. This is true in Case #1, Case #2, and Case #3. But in some cases the person taking the check might have detected the fraud and thus have prevented the loss by the exercise of ordinary care. In those cases, if that person failed to exercise ordinary care, it is reasonable that that person bear loss to the extent the failure contributed to the loss. Subsection (d) is intended to reach that result. It allows the person who suffers loss as a result of payment of the check to recover from the person who failed to exercise ordinary care. In Case #1, Case #2, and Case #3, the person suffering the loss is Corporation, the drawer of the check. In each case the most likely defendant is the depositary bank that took the check and failed to exercise ordinary care. In those cases, the drawer has a cause of action against the offending bank to recover a portion of the loss. The amount of loss to be allocated to each party is left to the trier of fact. Ordinary care is defined in Section 3-103(a)(7). An example of the type

of conduct by a depositary bank that could give rise to recovery under subsection (d) is discussed in Comment 4 to Section 3-405. That Comment addresses the last sentence of Section 3-405(b) which is similar to Section 3-404(d).

In Case #1, Case #2, and Case #3, there was no forgery of the drawer's signature. But cases involving checks payable to a fictitious payee or a payee not intended to have an interest in the check are often forged check cases as well. Examples are Case #4 and Case #5. Normally, the loss in forged check cases is on the drawee bank that paid the check. Case #5 is an example. In Case #4 the risk with respect to the forgery is shifted to the drawer because of the agreement between the drawer and the drawee bank. The doctrine that prevents a drawee bank from recovering payment with respect to a forged check if the payment was made to a person who took the check for value and in good faith is incorporated into Section 3-418 and Sections 3-417(a)(3) and 4-208(a)(3). This doctrine is based on the assumption that the depositary bank normally has no way of detecting the forgery because the drawer is not that bank's customer. On the other hand, the drawee bank, at least in some cases, may be able to detect the forgery by comparing the signature on the check with the specimen signature that the drawee has on file. But in some forged check cases the depositary bank is in a position to detect the fraud. Those cases typically involve a check payable to a fictitious payee or a payee not intended to have an interest in the check. Subsection (d) applies to those cases. If the depositary bank failed to exercise ordinary care and the failure substantially contributed to the loss, the drawer in Case #4 or the drawee bank in Case #5 has a cause of action against the depositary bank under subsection (d). Comment 4 to Section 3-405 can be used as a guide to the type of conduct that could give rise to recovery under Section 3-404(d).

ANNOTATION

Bank not bound to know fictitious character of payee. In an action by a depositor against a bank to recover money paid out on checks drawn by an authorized employee of the depositor, but made payable to fictitious payees and cashed by the employee, the bank is not liable to the depositor for paying such checks, inasmuch as it is not bound to know the fictitious character of a payee. Goodyear Tire & Rubber Co. v. First Nat'l Bank, 95 Colo. 34, 32 P.2d 268 (1934) (decided under repealed laws antecedent to CSA, C. 112, § 9 (3), negotiable instruments law).

4-3-405. Employer's responsibility for fraudulent indorsement by employee. (a) In this section:

(1) "Employee" includes an independent contractor and employee of an independent contractor retained by the employer.

(2) "Fraudulent indorsement" means (i) in the case of an instrument payable to the employer, a forged indorsement purporting to be that of the employer, or (ii) in the case of an instrument with respect to which the employer is the issuer, a forged indorsement purporting to be that of the person identified as payee.

(3) "Responsibility" with respect to instruments means authority (i) to sign or indorse instruments on behalf of the employer, (ii) to process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition, (iii) to prepare or process instruments for issue in the name of the employer, (iv) to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, (v) to control the disposition of instruments to be issued in the name of the employer, or (vi) to act otherwise with respect to instruments in a responsible capacity. "Responsibility" does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail, or similar access.

(b) For the purpose of determining the rights and liabilities of a person who, in good faith, pays an instrument or takes it for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee or a person acting in concert with the employee makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure contributes to loss resulting from the fraud, the person bearing the loss may

recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

(c) Under subsection (b) of this section, an indorsement is made in the name of the person to whom an instrument is payable if (i) it is made in a name substantially similar to the name of that person or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in name substantially similar to the name of that person.

Source: L. 94: Entire article R&RE, p. 864, § 1, effective January 1, 1995.

OFFICIAL COMMENT

1. Section 3-405 is addressed to fraudulent indorsements made by an employee with respect to instruments with respect to which the employer has given responsibility to the employee. It covers two categories of fraudulent indorsements: indorsements made in the name of the employer to instruments payable to the employer and indorsements made in the name of payees of instruments issued by the employer. This section applies to instruments generally but normally the instrument will be a check. Section 3-405 adopts the principle that the risk of loss for fraudulent indorsements by employees who are entrusted with responsibility with respect to checks should fall on the employer rather than the bank that takes the check or pays it, if the bank was not negligent in the transaction. Section 3-405 is based on the belief that the employer is in a far better position to avoid the loss by care in choosing employees, in supervising them, and in adopting other measures to prevent forged indorsements on instruments payable to the employer or fraud in the issuance of instruments in the name of the employer. If the bank failed to exercise ordinary care, subsection (b) allows the employer to shift loss to the bank to the extent the bank's failure to exercise ordinary care contributed to the loss. "Ordinary care" is defined in Section 3-103(a)(7). The provision applies regardless of whether the employer is negligent.

The first category of cases governed by Section 3-405 are those involving indorsements made in the name of payees of instruments issued by the employer. In this category, Section 3-405 includes cases that were covered by former Section 3-405(1)(c). The scope of Section 3-405 in revised Article 3 is, however, somewhat wider. It covers some cases not covered by former Section 3-405(1)(c) in which the entrusted employee makes a forged indorsement to a check drawn by the employer. An example is Case #6 in Comment 3. Moreover, a larger group of employees is included in revised Section 3-405. The key provision is the definition of "responsibility" in subsection (a)(1) which identifies the kind of responsibility delegated to an employee which will cause the employer to take responsibility for the fraudulent acts of that employee. An employer can insure this risk by employee fidelity bonds.

The second category of cases governed by Section 3-405 — fraudulent indorsements of the name of the employer to instruments payable to the employer — were covered in former Article 3 by Section 3-406. Under former Section 3-406, the employer took the loss only if negligence of the employer could be proved. Under revised Article 3, Section 3-406 need not be used with respect to forgeries of the employer's indorsement. Section 3-405 imposes the loss on the employer without proof of negligence.

2. With respect to cases governed by former Section 3-405(1)(c), Section 3-405 is more favorable to employers in one respect. The bank was entitled to the preclusion provided by former Section 3-405(1)(c) if it took the check in good faith. The fact that the bank acted negligently did not shift the loss to the bank so long as the bank acted in good faith. Under revised Section 3-405 the loss may be recovered from the bank to the extent the failure of the bank to exercise ordinary care contributed to the loss.

3. Section 3-404(b) and Section 3-405 both apply to cases of employee fraud. Section 3-404(b) is not limited to cases of employee fraud, but most of the cases to which it applies will be cases of employee fraud. The following cases illustrate the application of Section 3-405. In each case it is assumed that the bank that took the check acted in good faith and was not negligent.

Case #1. Janitor, an employee of Employer, steals a check for a very large amount payable to Employer after finding it on a desk in one of Employer's offices. Janitor forges Employer's indorsement on the check and obtains payment. Since Janitor was not entrusted with "responsibility" with respect to the check, Section 3-405 does not apply. Section 3-406 might apply to this case. The issue would be whether Employer was negligent in safeguarding the check. If not, Employer could assert that the indorsement was forged and bring an action for conversion against the depositary or payor bank under Section 3-420.

Case #2. X is Treasurer of Corporation and is authorized to write checks on behalf of Corporation by signing X's name as Treasurer. X draws a check in the name of Corporation and

signs X's name as Treasurer. The check is made payable to X. X then indorses the check and obtains payment. Assume that Corporation did not owe any money to X and did not authorize X to write the check. Although the writing of the check was not authorized, Corporation is bound as drawer of the check because X had authority to sign checks on behalf of Corporation. This result follows from agency law and Section 3-402(a). Section 3-405 does not apply in this case because there is no forged indorsement. X was payee of the check so the indorsement is valid. Section 3-110(a).

Case #3. The duties of Employee, a bookkeeper, include posting the amounts of checks payable to Employer to the accounts of the drawers of the checks. Employee steals a check payable to Employer which was entrusted to Employee and forges Employer's indorsement. The check is deposited by Employee to an account in Depositary Bank which Employee opened in the same name as Employer, and the check is honored by the drawee bank. The indorsement is effective as Employer's indorsement because Employee's duties include processing checks for bookkeeping purposes. Thus, Employee is entrusted with "responsibility" with respect to the check. Neither Depositary Bank nor the drawee bank is liable to Employer for conversion of the check. The same result follows if Employee deposited the check in the account in Depositary Bank without indorsement. Section 4-205(a). Under subsection (c) deposit in a depositary bank in an account in a name substantially similar to that of Employer is the equivalent of an indorsement in the name of Employer.

Case #4. Employee's duties include stamping Employer's unrestricted blank indorsement on checks received by Employer and depositing them in Employer's bank account. After stamping Employer's unrestricted blank indorsement on a check, Employee steals the check and deposits it in Employee's personal bank account. Section 3-405 doesn't apply because there is no forged indorsement. Employee is authorized by Employer to indorse Employer's checks. The fraud by Employee is not the indorsement but rather the theft of the indorsed check. Whether Employer has a cause of action against the bank in which the check was deposited is determined by whether the bank had notice of the breach of fiduciary duty by Employee. The issue is determined under Section 3-307.

Case #5. The computer that controls Employer's check-writing machine was programmed to cause a check to be issued to Supplier Co. to which money was owed by Employer. The address of Supplier Co. was included in the information in the computer. Employee is an accounts payable clerk whose duties include entering information into the computer. Employee fraudulently changed the address of Supplier Co. in the computer data bank to an address of Employee. The check was subsequently produced by the check-writing machine and mailed to the address that Employee had entered into the computer. Employee obtained possession of the check, indorsed it in the name of Supplier Co, and deposited it to an account in Depositary Bank which Employee opened in the name "Supplier Co." The check was honored by the drawee bank. The indorsement is effective under Section 3-405(b) because Employee's duties allowed Employee to supply information determining the address of the payee of the check. An employee that is entrusted with duties that enable the employee to determine the address to which a check is to be sent controls the disposition of the check and facilitates forgery of the indorsement. The employer is held responsible. The drawee may debit the account of Employer for the amount of the check. There is no breach of warranty by Depositary Bank under Section 3-417(a)(1) or 4-208(a)(1).

Case #6. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer draws a check of Corporation payable to Supplier Co., a company that sold goods to Corporation. The check was issued to pay the price of these goods. At the time the check was signed Treasurer had no intention of stealing the check. Later, Treasurer stole the check, indorsed it in the name "Supplier Co." and obtained payment by depositing it to an account in Depositary Bank which Treasurer opened in the name "Supplier Co.". The indorsement is effective under Section 3-405(b). Section 3-404(b) does not apply to this case.

Case #7. Checks of Corporation are signed by Treasurer in behalf of Corporation as drawer. Clerk's duties include the preparation of checks for issue by Corporation. Clerk prepares a check payable to the order of Supplier Co. for Treasurer's signature. Clerk fraudulently informs Treasurer that the check is needed to pay a debt owed to Supplier Co, a company that does business with Corporation. No money is owed to Supplier Co. and Clerk intends to steal the check. Treasurer signs it and returns it to Clerk for mailing. Clerk does not indorse the check but deposits it to an account in Depositary Bank which Clerk opened in the name "Supplier Co.". The check is honored by the drawee bank. Section 3-404(b)(i) does not apply to this case because Clerk, under Section 3-110(a), is not the person whose intent determines to whom the check is payable. But Section 3-405 does apply and it treats the deposit by Clerk as an effective indorsement by Clerk because Clerk was entrusted with responsibility with respect to the check. If Supplier Co. is a fictitious person Section 3-404(b)(ii) applies. But the result is the same. Clerk's deposit is treated as an effective indorsement of the check whether Supplier Co.

is a fictitious or a real person or whether money was or was not owing to Supplier Co. The drawee bank may debit the account of Corporation for the amount of the check and there is no breach of warranty by Depositary Bank under Section 3-417(1)(a).

4. The last sentence of subsection (b) is similar to subsection (d) of Section 3-404 which is discussed in Comment 3 to Section 3-404. In Case #5, Case #6, or Case #7 the depositary bank may have failed to exercise ordinary care when it allowed the employee to open an account in the name "Supplier Co.," to deposit checks payable to "Supplier Co." in that account, or to withdraw funds from that account that were proceeds of checks payable to Supplier Co. Failure to exercise ordinary care is to be determined in the context of all the facts relating to the bank's conduct with respect to the bank's collection of the check. If the trier of fact finds that there was such a failure and that the failure substantially contributed to loss, it could find the depositary bank liable to the extent the failure contributed to the loss. The last sentence of subsection (b) can be illustrated by an example. Suppose in Case #5 that the check is not payable to an obscure "Supplier Co." but rather to a well-known national corporation. In addition, the check is for a very large amount of money. Before depositing the check, Employee opens an account in Depositary Bank in the name of the corporation and states to the person conducting the transaction for the bank that Employee is manager of a new office being opened by the corporation. Depositary Bank opens the account without requiring Employee to produce any resolutions of the corporation's board of directors or other evidence of authorization of Employee to act for the corporation. A few days later, the check is deposited, the account is credited, and the check is presented for payment. After Depositary Bank receives payment, it allows Employee to withdraw the credit by a wire transfer to an account in a bank in a foreign country. The trier of fact could find that Depositary Bank did not exercise ordinary care and that the failure to exercise ordinary care contributed to the loss suffered by Employer. The trier of fact could allow recovery by Employer from Depositary Bank for all or part of the loss suffered by Employer.

4-3-406. Negligence contributing to forged signature or alteration of instrument. (a) A person whose failure to exercise ordinary care contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.

(b) Under subsection (a) of this section, if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.

(c) Under subsection (a) of this section, the burden of proving failure to exercise ordinary care is on the person asserting the preclusion. Under subsection (b) of this section, the burden of proving failure to exercise ordinary care is on the person precluded.

Source: L. 94: Entire article R&RE, p. 865, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-406 as it existed prior to 1994.

OFFICIAL COMMENT

1. Section 3-406(a) is based on former Section 3-406. With respect to alteration, Section 3-406 adopts the doctrine of **Young v. Grote,** 4 Bing. 253 (1827), which held that a drawer who so negligently draws an instrument as to facilitate its material alteration is liable to a drawee who pays the altered instrument in good faith. Under Section 3-406 the doctrine is expanded to apply not only to drafts but to all instruments. It includes in the protected class any "person who, in good faith, pays the instrument or takes it for value or for collection." Section 3-406 rejects decisions holding that the maker of a note owes no duty of care to the holder because at the time the instrument is issued there is no contract between them. By issuing the instrument and "setting it afloat upon a sea of strangers" the maker or drawer voluntarily enters into a relation with later holders which justifies imposition of a duty of care. In this respect an instrument so negligently drawn as to facilitate alteration does not differ in principle from an instrument containing blanks which may be filled. Under Section 3-407 a person paying an altered instrument or taking it for value, in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms. If negligence of the obligor substan-

tially contributes to an alteration, this section gives the holder or the payor the alternative right to treat the altered instrument as though it had been issued in the altered form.

No attempt is made to define particular conduct that will constitute "failure to exercise ordinary care [that] substantially contributes to an alteration." Rather, "ordinary care" is defined in Section 3-103(a)(7) in general terms. The question is left to the court or the jury for decision in the light of the circumstances in the particular case including reasonable commercial standards that may apply.

Section 3-406 does not make the negligent party liable in tort for damages resulting from the alteration. If the negligent party is estopped from asserting the alteration the person taking the instrument is fully protected because the taker can treat the instrument as having been issued in the altered form.

2. Section 3-406 applies equally to a failure to exercise ordinary care that substantially contributes to the making of a forged signature on an instrument. Section 3-406 refers to "forged signature" rather than "unauthorized signature" that appeared in former Section 3-406 because it more accurately describes the scope of the provision. Unauthorized signature is a broader concept that includes not only forgery but also the signature of an agent which does not bind the principal under the law of agency. The agency cases are resolved independently under agency law. Section 3-406 is not necessary in those cases.

The "substantially contributes" test of former Section 3-406 is continued in this section in preference to a "direct and proximate cause" test. The "substantially contributes" test is meant to be less stringent than a "direct and proximate cause" test. Under the less stringent test the preclusion should be easier to establish. Conduct "substantially contributes" to a material alteration or forged signature if it is a contributing cause of the alteration or signature and a substantial factor in bringing it about. The analysis of "substantially contributes" in former Section 3-406 by the court in **Thompson Maple Products v. Citizens National Bank of Corry,** 234 A.2d 32 (Pa. Super. Ct. 1967), states what is intended by the use of the same words in revised Section 3-406(b). Since Section 3-404(d) and Section 3-405(b) also use the words "substantially contributes" the analysis of these words also applies to those provisions.

3. The following cases illustrate the kind of conduct that can be the basis of a preclusion under Section 3-406(a):

Case #1. Employer signs checks drawn on Employer's account by use of a rubber stamp of Employer's signature. Employer keeps the rubber stamp along with Employer's personalized blank check forms in an unlocked desk drawer. An unauthorized person fraudulently uses the check forms to write checks on Employer's account. The checks are signed by use of the rubber stamp. If Employer demands that Employer's account in the drawee bank be recredited because the forged check was not properly payable, the drawee bank may defend by asserting that Employer is precluded from asserting the forgery. The trier of fact could find that Employer failed to exercise ordinary care to safeguard the rubber stamp and the check forms and that the failure substantially contributed to the forgery of Employer's signature by the unauthorized use of the rubber stamp.

Case #2. An insurance company draws a check to the order of Sarah Smith in payment of a claim of a policyholder, Sarah Smith, who lives in Alabama. The insurance company also has a policyholder with the same name who lives in Illinois. By mistake, the insurance company mails the check to the Illinois Sarah Smith who indorses the check and obtains payment. Because the payee of the check is the Alabama Sarah Smith, the indorsement by the Illinois Sarah Smith is a forged indorsement. Section 3-110(a). The trier of fact could find that the insurance company failed to exercise ordinary care when it mailed the check to the wrong person and that the failure substantially contributed to the making of the forged indorsement. In that event the insurance company could be precluded from asserting the forged indorsement against the drawee bank that honored the check.

Case #3. A company writes a check for $10. The figure "10" and the word "ten" are typewritten in the appropriate spaces on the check form. A large blank space is left after the figure and the word. The payee of the check, using a typewriter with a typeface similar to that used on the check, writes the word "thousand" after the word "ten" and a comma and three zeros after the figure "10". The drawee bank in good faith pays $10,000 when the check is presented for payment and debits the account of the drawer in that amount. The trier of fact could find that the drawer failed to exercise ordinary care in writing the check and that the failure substantially contributed to the alteration. In that case the drawer is precluded from asserting the alteration against the drawee if the check was paid in good faith.

4. Subsection (b) differs from former Section 3-406 in that it adopts a concept of comparative negligence. If the person precluded under subsection (a) proves that the person asserting the preclusion failed to exercise ordinary care and that failure substantially contributed to the loss, the loss may be allocated between the two parties on a comparative negligence basis. In the case of a forged indorsement the litigation is usually between the payee of the check and the depositary bank that took the check for collection. An example is a case like Case #1 of Comment 3 to Section 3-405. If

the trier of fact finds that Employer failed to exercise ordinary care in safeguarding the check and that the failure substantially contributed to the making of the forged indorsement, subsection (a) of Section 3-406 applies. If Employer brings an action for conversion against the depositary bank that took the checks from the forger, the depositary bank could assert the preclusion under subsection (a). But suppose the forger opened an account in the depositary bank in a name identical to that of Employer, the payee of the check, and then deposited the check in the account. Subsection (b) may apply. There may be an issue whether the depositary bank should have been alerted to possible fraud when a new account was opened for a corporation shortly before a very large check payable to a payee with the same name is deposited. Circumstances surrounding the opening of the account may have suggested that the corporation to which the check was payable may not be the same as the corporation for which the account was opened. If the trier of fact finds that collecting the check under these circumstances was a failure to exercise ordinary care, it could allocate the loss between the depositary bank and Employer, the payee.

ANNOTATION

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974). For article, "Commercial Law", which discusses a recent Tenth Circuit decision dealing with bank liability on forged commercial paper, see 62 Den. U. L. Rev. 84 (1985). For article, "Civil Liability for Check Forgeries in Colorado", see 16 Colo. Law. 959 (1987).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

For discussion of the standard of a bank's liability for payments made on forged withdrawal slips, see Bill Manning, Inc. v. Denver West Bank and Trust, 697 P.2d 403 (Colo. App. 1984).

Where undisputed evidence established that collecting bank failed to make inquiries as to the authority of a corporate treasurer to deposit checks payable to corporation into the personal account of the treasurer, the court properly determined that the bank had not acted according to reasonable commercial standards. Central Inc. v. Cache Nat'l Bank, 748 P.2d 351 (Colo. App. 1987).

Where bank fails to establish that payment of an altered instrument was in good faith and in accordance with reasonable commercial standards, plaintiff's negligence is irrelevant. Central Inc. v. Cache Nat'l Bank, 748 P.2d 351 (Colo. App. 1987).

Effect of stop-payment order on postdated check. Although a stop-payment order on a postdated check forbids payment by the bank to the payee or endorser, the maker remains liable on the instrument. Esecson v. Bushnell, 663 P.2d 258 (Colo. App. 1983).

While a payor bank's issuance of a cashier's check based on a forged power of attorney may have been a lax and even negligent business practice, it did not induce the collecting bank to accept and pay on the fraudulently endorsed checks and, therefore, was not the proximate cause of the improper payment of the checks. Vectra Bank of Englewood v. Bank Western, 890 P.2d 259 (Colo. App. 1995).

4-3-407. Alteration. (a) "Alteration" means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.

(b) Except as provided in subsection (c) of this section, an alteration fraudulently made discharges a party whose obligation is affected by the alteration unless that party assents or is precluded from asserting the alteration. No other alteration discharges a party, and the instrument may be enforced according to its original terms.

(c) A payor bank or drawee paying a fraudulently altered instrument or a person taking it for value, in good faith and without notice of the alteration, may enforce rights with respect to the instrument (i) according to its original terms, or (ii) in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed.

Source: L. 94: Entire article R&RE, p. 865, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-407 as it existed prior to 1994.

OFFICIAL COMMENT

1. This provision restates former Section 3-407. Former Section 3-407 defined a "material" alteration as any alteration that changes the contract of the parties in any respect. Revised Section 3-407 refers to such a change as an alteration. As under subsection (2) of former Section 3-407, discharge because of alteration occurs only in the case of an alteration fraudulently made. There is no discharge if a blank is filled in the honest belief that it is authorized or if a change is made with a benevolent motive such as a desire to give the obligor the benefit of a lower interest rate. Changes favorable to the obligor are unlikely to be made with any fraudulent intent, but if such an intent is found the alteration may operate as a discharge.

Discharge is a personal defense of the party whose obligation is modified and anyone whose obligation is not affected is not discharged. But if an alteration discharges a party there is also discharge of any party having a right of recourse against the discharged party because the obligation of the party with the right of recourse is affected by the alteration. Assent to the alteration given before or after it is made will prevent the party from asserting the discharge. The phrase "or is precluded from asserting the alteration" in subsection (b) recognizes the possibility of an estoppel or other ground barring the defense which does not rest on assent.

2. Under subsection (c) a person paying a fraudulently altered instrument or taking it for value, in good faith and without notice of the alteration, is not affected by a discharge under subsection (b). The person paying or taking the instrument may assert rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument that is altered by unauthorized completion, according to its terms as completed. If blanks are filled or an incomplete instrument is otherwise completed, subsection (c) places the loss upon the party who left the instrument incomplete by permitting enforcement in its completed form. This result is intended even though the instrument was stolen from the issuer and completed after the theft.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Alteration of a promissory note renders it invalid. Farmers State Bank v. Klein, 159 Colo. 165, 410 P.2d 632 (1966).

Where a promissory note, blank as to the rate of interest and the time from which interest is to be computed, is subscribed by the maker, as well as the sureties, and delivered by the maker to the payee, who, without authority of the sureties, fills the blanks and advances money thereon to the maker, the alteration is a material one, and, consequently, the instrument is thereby avoided. Ayres v. Walker, 54 Colo. 571, 131 P. 384 (1913).

Reason for rule. This is an old and wise provision of the law, and the reason for it is apparent when we consider the absoluteness of custody and control by the payee or holder and the utter helplessness to prevent an alteration in the case of the maker in that respect. And so the law has provided as a penalty, not only of criminal liability, but a forfeiture and cancellation of the obligation in its entirety. Ayres v. Walker, 54 Colo. 571, 131 P. 384 (1913).

One is estopped as against a H.D.C. One who signs a promissory note with blank spaces for interest which are subsequently filled in by the payee and thereafter assigned to a holder in due course without knowledge thereof is estopped to defend on the ground of alteration. Statton v. Stone, 15 Colo. App. 237, 61 P. 481 (1900).

An alteration on the face of a note reducing the principal, but made honestly with the intention of making a proper credit, does not bar recovery on the note. Whitehead v. Emmerich, 38 Colo. 13, 87 P. 790 (1906).

The contention of claimant that the burden of explaining an alteration of the date of a note upon which his claim was based was not upon him since the defendant had not objected on that ground was overruled. Gavin v. Kniffen, 82 Colo. 448, 261 P. 6 (1927).

Defense of alteration must be based on preponderance of evidence. Where the defense of fraudulent alteration is interposed in an action on a promissory note, an instruction that the jury can find for the defendant only upon a clear satisfactory preponderance of the evidence is sufficient. Brunton v. Ditto, 51 Colo. 178, 117 P. 156 (1911).

4-3-408. Drawee not liable on unaccepted draft. A check or other draft does not of itself operate as an assignment of funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until the drawee accepts it.

Source: L. 94: Entire article R&RE, p. 865, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-409 as it existed prior to 1994.

OFFICIAL COMMENT

1. This section is a restatement of former Section 3-409(1). Subsection (2) of former Section 3-409 is deleted as misleading and superfluous. Comment 3 says of subsection (2): "It is intended to make it clear that this section does not in any way affect any liability which may arise apart from the instrument." In reality subsection (2) did not make anything clear and was a source of confusion. If all it meant was that a bank that has not certified a check may engage in other conduct that might make it liable to a holder, it stated the obvious and was superfluous. Section 1-103 is adequate to cover those cases.

2. Liability with respect to drafts may arise under other law. For example, Section 4-302 imposes liability on a payor bank for late return of an item.

ANNOTATION

I. GENERAL CONSIDERATION.

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

II. DRAFT NOT AN ASSIGNMENT.

The giving of a check does not assign present funds on deposit and does not create drawee liability to the payee unless and until it is accepted by the drawee. Denver Elec. & Neon Serv. Corp. v. Gerald H. Phipps, Inc., 143 Colo. 530, 354 P.2d 618 (1960).

Bank may decline payment. Even where a signature to a check is correct, and all other required indicia appear thereon, still, the bank on which a check is drawn is not liable in action to the drawee thereof and in all legal grace may decline payment of the check. Henderson v. Greeley Nat'l Bank, 111 Colo. 365, 142 P.2d 480 (1943).

Even before the passage of the negotiable instrument law it was ruled that a right of action did not exist in favor of the holder of a check against the drawee bank where there has been no acceptance or promise to pay by the latter in Colo. Nat'l Bank v. Boettcher, (5 Colo. 185 (1879), aff'd, 15 Colo. 16, 24 P. 582 (1890)), and the statute has expressly enacted such. Van Buskirk v. State Bank, 35 Colo. 142, 83 P. 778 (1905).

III. OTHER LIABILITY NOT AFFECTED.

A promise to accept a bill or order made before the bill or order is drawn may be enforced against the party making the promise by one who purchases such bill or order relying upon the faith of the promise, and the drawee cannot avoid liability by proof of a contingent condition precedent where such orders were not drawn in excess of the amount of the promise. McPhee & McGinnity v. Fowler, 36 Colo. 202, 85 P. 421 (1906) (decided under repealed laws antecedent to CSA, C. 112, § 127, negotiable instruments law).

4-3-409. Acceptance of draft; certified check. (a) "Acceptance" means the drawee's signed agreement to pay a draft as presented. It must be written on the draft and may consist of the drawee's signature alone. Acceptance may be made at any time and becomes effective when notification pursuant to instructions is given or the accepted draft is delivered for the purpose of giving rights on the acceptance to any person.

(b) A draft may be accepted although it has not been signed by the drawer, is otherwise incomplete, is overdue, or has been dishonored.

(c) If a draft is payable at a fixed period after sight and the acceptor fails to date the acceptance, the holder may complete the acceptance by supplying a date in good faith.

(d) "Certified check" means a check accepted by the bank on which it is drawn. Acceptance may be made as stated in subsection (a) of this section or by a writing on the check which indicates that the check is certified. The drawee of a check has no obligation to certify the check, and refusal to certify is not dishonor of the check.

Source: L. 94: Entire article R&RE, p. 866, § 1, effective January 1, 1995.

Editor's note: This section is similar to former §§ 4-3-409, 4-3-410, and 4-3-411 as they existed prior to 1994.

OFFICIAL COMMENT

1. The first three subsections of Section 3-409 are a restatement of former Section 3-410. Subsection (d) adds a definition of certified check which is a type of accepted draft.

2. Subsection (a) states the generally recognized rule that the mere signature of the drawee on the instrument is a sufficient acceptance. Customarily the signature is written vertically across the face of the instrument, but since the drawee has no reason to sign for any other purpose a signature in any other place, even on the back of the instrument, is sufficient. It need not be accompanied by such words as "Accepted," "Certified," or "Good." It must not, however, bear any words indicating an intent to refuse to honor the draft. The last sentence of subsection (a) states the generally recognized rule that an acceptance written on the draft takes effect when the drawee notifies the holder or gives notice according to instructions.

3. The purpose of subsection (c) is to provide a definite date of payment if none appears on the instrument. An undated acceptance of a draft payable "thirty days after sight" is incomplete. Unless the acceptor writes in a different date the holder is authorized to complete the acceptance according to the terms of the draft by supplying a date of acceptance. Any date supplied by the holder is effective if made in good faith.

4. The last sentence of subsection (d) states the generally recognized rule that in the absence of agreement a bank is under no obligation to certify a check. A check is a demand instrument calling for payment rather than acceptance. The bank may be liable for breach of any agreement with the drawer, the holder, or any other person by which it undertakes to certify. Its liability is not on the instrument, since the drawee is not so liable until acceptance. Section 3-408. Any liability is for breach of the separate agreement.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Acceptance of a bill at common law and under this section is merely the signification by the drawee of his assent to the order of the drawer. The legal meaning of an acceptance is that the acceptor engages to pay the instrument according to the tenor of his acceptance; in other words, it is a promise to pay. Van Buskirk v. State Bank, 35 Colo. 142, 83 P. 778 (1905).

An agreement in writing to honor a draft is sufficient to create liability to a bank which in reliance thereon is the assignee for value of the draft. Posey v. Denver Nat'l Bank, 24 Colo. 199, 49 P. 282 (1897).

A drawer may recover of an acceptor upon a verbal acceptance, whether the drawer's funds are in the acceptor's hands upon acceptance or later. Durkee v. Conklin, 13 Colo. App. 313, 57 P. 486 (1899).

Such acceptance is outside the statute of frauds because it is only a promise to pay another's funds on his order. Durkee v. Conklin, 13 Colo. App. 313, 57 P. 486 (1899).

Drawee may be estopped by conduct to assert that acceptance was not in writing. Mumm v. Taylor, 121 Colo. 157, 213 P.2d 836 (1950).

Section applies to checks. Though a check need not be presented for acceptance in order to render the parties thereto liable, still the check itself does not operate as an assignment of any part of the fund to the credit of the drawer with the bank and the drawee bank is not liable to the holder, unless and until it accepts or certifies the check, and, except as otherwise provided all provisions applicable to a bill of exchange payable on demand apply to a check. Consequently, as no contrary provision for the acceptance of or promise to pay a check has been made, the provision applicable to a bill of exchange (i.e., draft) that acceptance or certification when made must be in writing applies also to a check. Van Buskirk v. State Bank, 35 Colo. 142, 83 P. 778 (1905).

Where upon inquiry by correspondent bank as agent of the drawer, the bank agrees to honor check, such assent constitutes an acceptance; and upon dishonor, drawer can maintain an action for breach of the agreement. Sigel-Campion Live Stock Co. v. Davis, 69 Colo. 511, 194 P. 468 (1921). See Gambrill v. Brown Hotel Co., 11 Colo. App. 529, 54 P. 1025 (1898).

Drawer discharged by acceptance. Where the payee of a bank check procures acceptance by the bank upon which it is drawn, upon which acceptance he obtains judgment against the latter, he cannot pursue a further remedy against the drawer of the check in the same matter, there being as to such drawer a positive statutory discharge. Roberts v. Sch. Dist. No. 1, 99 Colo. 484, 63 P.2d 1232 (1936) (decided under repealed CSA, C. 112, § 188, negotiable instruments law).

4-3-410. Acceptance of varying draft. (a) If the terms of a drawee's acceptance vary from the terms of the draft as presented, the holder may refuse the acceptance and treat the

draft as dishonored. In that case, the drawee may cancel the acceptance.

(b) The terms of a draft are not varied by an acceptance to pay at a particular bank or place in the United States, unless the acceptance states that the draft is to be paid only at that bank or place.

(c) If the holder assents to an acceptance varying the terms of a draft, the obligation of each drawer and indorser that does not expressly assent to the acceptance is discharged.

Source: L. 94: Entire article R&RE, p. 866, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-412 as it existed prior to 1994.

OFFICIAL COMMENT

1. This section is a restatement of former Section 3-412. It applies to conditional acceptances, acceptances for part of the amount, acceptances to pay at a different time from that required by the draft, or to the acceptance of less than all of the drawees. It applies to any other engagement changing the essential terms of the draft. If the drawee makes a varied acceptance the holder may either reject it or assent to it. The holder may reject by insisting on acceptance of the draft as presented. Refusal by the drawee to accept the draft as presented is dishonor. In that event the drawee is not bound by the varied acceptance and is entitled to have it canceled.

If the holder assents to the varied acceptance, the drawee's obligation as acceptor is according to the terms of the varied acceptance. Under subsection (c) the effect of the holder's assent is to discharge any drawer or indorser who does not also assent. The assent of the drawer or indorser must be affirmatively expressed. Mere failure to object within a reasonable time is not assent which will prevent the discharge.

2. Under subsection (b) an acceptance does not vary from the terms of the draft if it provides for payment at any particular bank or place in the United States unless the acceptance states that the draft is to be paid only at such bank or place. Section 3-501(b)(1) states that if an instrument is payable at a bank in the United States presentment must be made at the place of payment (Section 3-111) which in this case is at the designated bank.

ANNOTATION

A conditional acceptance is as binding and effective as an absolute acceptance upon compliance with the conditions, but ineffective when the conditions have not been and probably never will be fulfilled. Barnsdall v. Waltemeyer, 142 F. 415 (8th Cir. 1905), cert. denied, 201 U.S. 643, 26 S. Ct. 759, 50 L. Ed. 902 (1906) (decided under repealed laws antecedent to CSA, C. 112, § 141, negotiable instruments law).

4-3-411. Refusal to pay cashier's checks, teller's checks, and certified checks. (a) In this section, "obligated bank" means the acceptor of a certified check or the issuer of a cashier's check or teller's check bought from the issuer.

(b) If the obligated bank wrongfully (i) refuses to pay a cashier's check or certified check, (ii) stops payment on a teller's check, or (iii) refuses to pay a dishonored teller's check, the person asserting the right to enforce the check is entitled to compensation for expenses and loss of interest resulting from the nonpayment and may recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages.

(c) Expenses or consequential damages under subsection (b) are not recoverable if the refusal of the obligated bank pay occurs because (i) the bank suspends payments, (ii) the obligated bank asserts a claim or defense of the bank that it has reasonable grounds to believe is available against the person entitled to enforce the instrument, (iii) the obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the instrument, or (iv) payment is prohibited by law.

Source: L. 94: Entire article R&RE, p. 867, § 1, effective January 1, 1995. **L. 2005:** (b) amended, p. 760, § 9, effective June 1.

OFFICIAL COMMENT

1. In some cases a creditor may require that the debt be paid by an obligation of a bank. The debtor may comply by obtaining certification of the debtor's check, but more frequently the debtor buys from a bank a cashier's check or teller's check payable to the creditor. The check is taken by the creditor as a cash equivalent on the assumption that the bank will pay the check. Sometimes, the debtor wants to retract payment by inducing the obligated bank not to pay. The typical case involves a dispute between the parties to the transaction in which the check is given in payment. In the case of a certified check or cashier's check, the bank can safely pay the holder of the check despite notice that there may be an adverse claim to the check (Section 3-602). It is also clear that the bank that sells a teller's check has no duty to order the bank on which it is drawn not to pay it. A debtor using any of these types of checks has no right to stop payment. Nevertheless, some banks will refuse payment as an accommodation to a customer. Section 3-411 is designed to discourage this practice.

2. The term "obligated bank" refers to the issuer of the cashier's check or teller's check and the acceptor of the certified check. If the obligated bank wrongfully refuses to pay, it is liable to pay for expenses and loss of interest resulting from the refusal to pay. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses * * * resulting from the nonpayment." In addition the bank may be liable to pay consequential damages if it has notice of the particular circumstances giving rise to the damages.

3. Subsection (c) provides that expenses or consequential damages are not recoverable if the refusal to pay is because of the reasons stated. The purpose is to limit that recovery to cases in which the bank refuses to pay even though its obligation to pay is clear and it is able to pay. Subsection (b) applies only if the refusal to honor the check is wrongful. If the bank is not obliged to pay there is no recovery. The bank may assert any claim or defense that it has, but normally the bank would not have a claim or defense. In the usual case it is a remitter that is asserting a claim to the check on the basis of a rescission of negotiation to the payee under Section 3-202. See Comment 2 to Section 3-201. The bank can assert that claim if there is compliance with Section 3-305(c), but the bank is not protected from damages under subsection (b) if the claim of the remitter is not upheld. In that case, the bank is insulated from damages only if payment is enjoined under Section 3-602(b)(1). Subsection (c)(iii) refers to cases in which the bank may have a reasonable doubt about the identity of the person demanding payment. For example, a cashier's check is payable to "Supplier Co." The person in possession of the check presents it for payment over the counter and claims to be an officer of Supplier Co. The bank may refuse payment until it has been given adequate proof that the presentment in fact is being made for Supplier Co., the person entitled to enforce the check.

4-3-412. Obligation of issuer of note or cashier's check. The issuer of a note or cashier's check or other draft drawn on the drawer is obliged to pay the instrument (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the issuer signed an incomplete instrument, according to its terms when completed, to the extent stated in sections 4-3-115 and 4-3-407. The obligation is owed to a person entitled to enforce the instrument or to an indorser who paid the instrument under section 4-3-415.

Source: L. 94: Entire article R&RE, p. 867, § 1, effective January 1, 1995.

OFFICIAL COMMENT

1. The obligations of the maker, acceptor, drawer, and indorser are stated in four separate sections. Section 3-412 states the obligation of the maker of a note and is consistent with former Section 3-413(1). Section 3-412 also applies to the issuer of a cashier's check or other draft drawn on the drawer. Under former Section 3-118(a), since a cashier's check or other draft drawn on the drawer was "effective as a note," the drawer was liable under former Section 3-413(1) as a maker. Under Section 3-103(a)(6) and 3-104(f) a cashier's check or other draft drawn on the drawer is treated as a draft to reflect common commercial usage, but the liability of the drawer is stated by Section 3-412 as being the same as that of the maker of a note rather than that of the drawer of a draft. Thus, Section 3-412 does not in substance change former law.

2. Under Section 3-105(b) nonissuance of either a complete or incomplete instrument is a defense by a maker or drawer against a person

that is not a holder in due course.

3. The obligation of the maker may be modified in the case of alteration if, under Section 3-406, the maker is precluded from asserting the alteration.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Makers engage under this section to pay a note according to its tenor upon its falling due. Reese v. Lietzan, 160 Colo. 253, 419 P.2d 959 (1966).

The burden of avoidance is on maker. Where the maker makes no claim of mistake in the making of his written promise and the note on its face bears a consideration, the burden of avoidance of payment rests solely upon the maker. McCaffrey v. Mitchell, 98 Colo. 467, 56 P.2d 926, 57 P.2d 900 (1936).

Presumption does not apply where fiduciary relationship. The general presumption of liability of maker of promissory notes is over come by the specific presumption arising out of where there is a fiduciary relationship, in which case the claimant must overcome, by evidence, the presumption of undue influence with which the transaction is tainted because of the existence of the fiduciary relationship. Arnold v. Abernethy, 134 Colo. 573, 307 P.2d 1106 (1957).

The thoughts and purposes of the maker, not disclosed at the execution of the contract, may not be given to the jury in an attempt to show that the instrument means something other than what is shown on its face. McCaffrey v. Mitchell, 98 Colo. 467, 56 P.2d 926, 57 P.2d 900 (1936).

Maker cannot be heard to say that payee committed an illegal act in taking instrument, or had no authority to dispose of it, in the usual course of business, because, by its execution and delivery, he is precluded from raising any of these questions as against purchasers who obtained it for value before maturity without notice of the facts upon which he relies to defeat it. McMann v. Walker, 31 Colo. 261, 72 P. 1055 (1903).

Such as note given to foreign corporation which fails to comply with statutory prerequisites for doing business. See McMann v. Walker, 31 Colo. 261, 72 P. 1055 (1903).

The equities that may exist between payees governing the division of funds paid pursuant to a commercial promissory note are none of the makers' concern, as they must simply pay the note according to its tenor to the holder at maturity. Reese v. Lietzan, 160 Colo. 253, 419 P.2d 959 (1966).

Who is deemed the prima facie owner. Where an action is brought on a promissory note payable to the maker and indorsed in blank by him with a guarantee of payment, one having possession of the note is prima facie owner thereof and can recover against the maker as such. Byers v. Bellan-Price Co., 10 Colo. App. 74, 50 P. 368 (1897).

The maker of a promissory note may plead that another is the real owner thereof, that the action is prosecuted for his benefit, and set upon an indebtedness due and owing by such party in interest to him. Bank of Bromfield v. McKinlay, 53 Colo. 279, 125 P. 493 (1912).

Demand is not a condition precedent to an action on a note against the maker. Erdman v. Hardesty, 14 Colo. App. 395, 60 P. 360 (1900).

Including of bank holding municipal bonds. Where a municipality issues bonds, payable at the option of the holder at a bank, the failure of a holder to present the bonds for payment at such bank does not relieve the municipality as maker, although the bonds and payment fund have been forwarded to the bank by the municipality. Employers Mut. Ins. Co. v. Bd. of County Comm'rs, 102 Colo. 177, 78 P.2d 380 (1938).

Where money has been diverted from fund, bondholders may sue on the bonds as for a money demand and not be relegated to a mandamus action. Employers Mut. Ins. Co. v. Bd. of County Comm'rs, 102 Colo. 177, 78 P.2d 380 (1938).

Where a promissory note is executed and unconditionally delivered to a real estate agency as payee as part of a purchase price agreement, the payee may maintain an action upon the note without regard to any interest therein of the owner of the properly sold. Hubby v. Willis Agency, Inc., 131 Colo. 565, 283 P.2d 1080 (1955). See Retallic v. Dixon, 75 Colo. 123, 224 P. 1054 (1924).

Rule prior to N.I.L. made surety a joint maker. Edmonston v. Ascough, 43 Colo. 55, 95 P. 313 (1908).

4-3-413. Obligation of acceptor. (a) The acceptor of a draft is obliged to pay the draft (i) according to its terms at the time it was accepted, even though the acceptance states that the draft is payable "as originally drawn" or equivalent terms, (ii) if the acceptance varies the terms of the draft, according to the terms of the draft as varied, or (iii) if the acceptance is of a draft that is an incomplete instrument, according to its terms when completed, to the extent stated in sections 4-3-115 and 4-3-407. The obligation is owed to

a person entitled to enforce the draft or to the drawer or an indorser who paid the draft under section 4-3-414 or 4-3-415.

(b) If the certification of a check or other acceptance of a draft states the amount certified or accepted, the obligation of the acceptor is that amount. If (i) the certification or acceptance does not state an amount, (ii) the amount of the instrument is subsequently raised, and (iii) the instrument is then negotiated to a holder in due course, the obligation of the acceptor is the amount of the instrument at the time it was taken by the holder in due course.

Source: L. 94: Entire article R&RE, p. 867, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-413 as it existed prior to 1994.

OFFICIAL COMMENT

Subsection (a) is consistent with former Section 3-413(1). Subsection (b) has primary importance with respect to certified checks. It protects the holder in due course of a certified check that was altered after certification and before negotiation to the holder in due course. A bank can avoid liability for the altered amount by stating on the check the amount the bank agrees to pay. The subsection applies to other accepted drafts as well.

4-3-414. Obligation of drawer. (a) This section does not apply to cashier's checks or other drafts drawn on the drawer.

(b) If an unaccepted draft is dishonored, the drawer is obliged to pay the draft (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the drawer signed an incomplete instrument, according to its terms when completed, to the extent stated in sections 4-3-115 and 4-3-407. The obligation is owed to a person entitled to enforce the draft or to an indorser who paid the draft under section 4-3-415.

(c) If a draft is accepted by a bank, the drawer is discharged, regardless of when or by whom acceptance was obtained.

(d) If a draft is accepted and the acceptor is not a bank, the obligation of the drawer to pay the draft if the draft is dishonored by the acceptor is the same as the obligation of an indorser under section 4-3-415 (a) and (c).

(e) If a draft states that it is drawn "without recourse" or otherwise disclaims liability of the drawer to pay the draft, the drawer is not liable under subsection (b) of this section to pay the draft if the draft is not a check. A disclaimer of the liability stated in subsection (b) of this section is not effective if the draft is a check.

(f) If (i) a check is not presented for payment or given to a depositary bank for collection within thirty days after its date, (ii) the drawee suspends payments after expiration of the thirty-day period without paying the check, and (iii) because of the suspension of payments, the drawer is deprived of funds maintained with the drawee to cover payment of the check, the drawer to the extent deprived of funds may discharge its obligation to pay the check by assigning to the person entitled to enforce the check the rights of the drawer against the drawee with respect to the funds.

Source: L. 94: Entire article R&RE, p. 867, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-413 as it existed prior to 1994.

OFFICIAL COMMENT

1. Subsection (a) excludes cashier's checks because the obligation of the issuer of a cashier's check is stated in Section 3-412.

2. Subsection (b) states the obligation of the drawer on an unaccepted draft. It replaces former Section 3-413(2). The requirement under former Article 3 of notice of dishonor or protest has been eliminated. Under revised Article 3, notice of dishonor is necessary only with respect to indorser's liability. The liability of the drawer

of an unaccepted draft is treated as a primary liability. Under former Section 3-102(1)(d) the term "secondary party" was used to refer to a drawer or indorser. The quoted term is not used in revised Article 3. The effect of a draft drawn without recourse is stated in subsection (e).

3. Under subsection (c) the drawer is discharged of liability on a draft accepted by a bank regardless of when acceptance was obtained. This changes former Section 3-411(1) which provided that the drawer is discharged only if the holder obtains acceptance. Holders that have a bank obligation do not normally rely on the drawer to guarantee the bank's solvency. A holder can obtain protection against the insolvency of a bank acceptor by a specific guaranty of payment by the drawer or by obtaining an indorsement by the drawer. Section 3-205(d).

4. Subsection (d) states the liability of the drawer if a draft is accepted by a drawee other than a bank and the acceptor dishonors. The drawer of an unaccepted draft is the only party liable on the instrument. The drawee has no liability on the draft. Section 3-408. When the draft is accepted, the obligations change. The drawee, as acceptor, becomes primarily liable and the drawer's liability is that of a person secondarily liable as a guarantor of payment. The drawer's liability is identical to that of an indorser, and subsection (d) states the drawer's liability that way. The drawer is liable to pay the person entitled to enforce the draft or any indorser that pays pursuant to Section 3-415. The drawer in this case is discharged if notice of dishonor is required by Section 3-503 and is not given in compliance with that section. A drawer that pays has a right of recourse against the acceptor. Section 3-413(a).

5. Subsection (e) does not permit the drawer of a check to avoid liability under subsection (b) by drawing the check without recourse. There is no legitimate purpose served by issuing a check on which nobody is liable. Drawing without recourse is effective to disclaim liability of the drawer if the draft is not a check. Suppose, in a documentary sale, Seller draws a draft on Buyer for the price of goods shipped to Buyer. The draft is payable upon delivery to the drawee of an order bill of lading covering the goods. Seller delivers the draft with the bill of lading to Finance Company that is named as payee of the draft. If Seller draws without recourse Finance Company takes the risk that Buyer will dishonor. If Buyer dishonors, Finance Company has no recourse against Seller but it can obtain reimbursement by selling the goods which it controls through the bill of lading.

6. Subsection (f) is derived from former Section 3-502(1)(b). It is designed to protect the drawer of a check against loss resulting from suspension of payments by the drawee bank when the holder of the check delays collection of the check. For example, X writes a check payable to Y for $1,000. The check is covered by funds in X's account in the drawee bank. Y delays initiation of collection of the check for more than 30 days after the date of the check. The drawee bank suspends payments after the 30-day period and before the check is presented for payment. If the $1,000 of funds in X's account have not been withdrawn, X has a claim for those funds against the drawee bank and, if subsection (e) were not in effect, X would be liable to Y on the check because the check was dishonored. Section 3-502(e). If the suspension of payments by the drawee bank will result in payment to X of less than the full amount of the $1,000 in the account or if there is a significant delay in payment to X, X will suffer a loss which would not have been suffered if Y had promptly initiated collection of the check. In most cases, X will not suffer any loss because of the existence of federal bank deposit insurance that covers accounts up to $100,000. Thus, subsection (e) has relatively little importance. There might be some cases, however, in which the account is not fully insured because it exceeds $100,000 or because the account doesn't qualify for deposit insurance. Subsection (f) retains the phrase "deprived of funds maintained with the drawee" appearing in former Section 3-502(1)(b). The quoted phrase applies if the suspension of payments by the drawee prevents the drawer from receiving the benefit of funds which would have paid the check if the holder had been timely in initiating collection. Thus, any significant delay in obtaining full payment of the funds is a deprivation of funds. The drawer can discharge drawer's liability by assigning rights against the drawee with respect to the funds to the holder.

ANNOTATION

The drawer of a check is not presumed to know the signature of the payee. Goodyear Tire & Rubber Co. v. First Nat'l Bank, 95 Colo. 34, 32 P.2d 268 (1934) (decided under repealed laws antecedent to CSA, C. 112 § 61, negotiable instruments law).

4-3-415. Obligation of indorser. (a) Subject to subsections (b), (c), (d) and (e) of this section and to section 4-3-419 (d), if an instrument is dishonored, an indorser is obliged to pay the amount due on the instrument (i) according to the terms of the instrument at the time it was indorsed, or (ii) if the indorser indorsed an incomplete instrument, according to its

terms when completed, to the extent stated in sections 4-3-115 and 4-3-407. The obligation of the indorser is owed to a person entitled to enforce the instrument or to a subsequent indorser who paid the instrument under this section.

(b) If an indorsement states that it is made "without recourse" or otherwise disclaims liability of the indorser, the indorser is not liable under subsection (a) of this section to pay the instrument.

(c) If notice of dishonor of an instrument is required by section 4-3-503 and notice of dishonor complying with that section is not given to an indorser, the liability of the indorser under subsection (a) of this section is discharged.

(d) If a draft is accepted by a bank after an indorsement is made, the liability of the indorser under subsection (a) of this section is discharged.

(e) If an indorser of a check is liable under subsection (a) of this section and the check is not presented for payment, or given to a depositary bank for collection, within thirty days after the day the indorsement was made, the liability of the indorser under subsection (a) of this section is discharged.

Source: L. 94: Entire article R&RE, p. 868, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-414 as it existed prior to 1994.

OFFICIAL COMMENT

1. Subsection (a) and (b) restate the substance of former Section 3-414(1). Subsection (2) of former Section 3-414 has been dropped because it is superfluous. Although notice of dishonor is not mentioned in subsection (a), it must be given in some cases to charge an indorser. It is covered in subsection (c). Regulation CC § 229.35(b) provides that a bank handling a check for collection or return is liable to a bank that subsequently handles the check to the extent the latter bank does not receive payment for the check. This liability applies whether or not the bank incurring the liability indorsed the check.

2. Section 3-503 states when notice of dishonor is required and how it must be given. If required notice of dishonor is not given in compliance with Section 3-503, subsection (c) of Section 3-415 states that the effect is to discharge the indorser's obligation.

3. Subsection (d) is similar in effect to Section 3-414(c) if the draft is accepted by a bank after the indorsement is made. See Comment 3 to Section 3-414. If a draft is accepted by a bank before the indorsement is made, the indorser incurs the obligation stated in subsection (a).

4. Subsection (e) modifies former Sections 3-503(2)(b) and 3-502(1)(a) by stating a 30-day rather than a seven-day period, and stating it as an absolute rather than a presumptive period.

ANNOTATION

I. GENERAL CONSIDERATION.

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Parol evidence is admissible to determine if reformation of instrument is appropriate where misrepresentations of legal effect of contract by assignee's attorney was alleged. Boyles Bros. Drilling v. Orion Indust., Ltd., 761 P.2d 278 (Colo. App. 1988).

II. CONTRACT OF INDORSER.

A. "Without Recourse".

Annotator's note. Since § 4-3-114 is similar to repealed laws antecedent to CSA, C. 112, § 38 (negotiable instruments law), relevant cases construing those provisions have been included in the annotations to this section.

One who by false representations as to the solvency of the maker of a promissory note induces another to accept it under an indorsement "without recourse" is liable to an action of deceit and the injured party is not concluded by the character of the indorsement. Pallister v. Camenisch, 21 Colo. App. 79, 121 P. 958 (1912).

Where a bank indorses a note over to its president for collection, but he later indorses it back to the bank without recourse, and the bank

delivers the note without further indorsement to a third party for a valuable consideration, the bank is liable as an indorser without further indorsement. Moore v. First Nat'l Bank, 38 Colo. 336, 88 P. 385 (1907).

Where a mortgage assigns "with the notes therein described without recourse", though the notes have been indorsed prior to the assignment, then the indorsement and assignment are considered as parts of one transaction, though of different dates, and are therefore construed together. Gillett v. Flora, 68 Colo. 218, 187 P. 527 (1920).

B. Liability.

Each indorser entitled to notice of dishonor. Where a complaint against numerous individuals alleges their liability as "indorsers", each of them is entitled to notice of dishonor precedent to any liability. Bieser v. Irwin, 101 Colo. 210, 72 P.2d 271 (1937).

Where there is a waiver of protest. By placing one's signature upon a note before delivery he becomes an indorser, and if the note contains a waiver of protest, he is not entitled to demand and notice, with his ability, therefore, being governed by this section where he is to pay the holder if the maker does not. Sproul v. Monteith, 66 Colo. 541, 185 P. 270 (1919).

The indorser of a promissory note is not a party to a warrant to confess judgment. Sproul v. Monteith, 66 Colo. 541, 185 P. 270 (1919).

Consequently, a judgment against him without service of process is void. Sproul v. Monteith, 66 Colo. 541, 185 P. 270 (1919).

Liability where estoppel created. While the principle that an indorser is liable on his warranty is correctly stated, the rule has no application when an estoppel has been created which would preclude plaintiff from obtaining a refund of the amount paid to defendant. First Nat'l Bank v. Ulibarri, 38 Colo. App. 428, 557 P.2d 1221 (1976).

Applied in Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954).

III. ORDER OF LIABILITY.

Where one, subsequent to discounting of notes to a bank, indorses his name thereon after that of the payee, this, prima facie makes him liable as an indorser after the latter, but such presumption can be overcome by proof. Loveland v. Sigel-Campion Live Stock Co., 77 Colo. 22, 234 P. 168 (1925) (decided under repealed laws antecedent to CSA, C. 112, § 64, negotiable instruments law).

Applied in Faden v. Midcap's Estate, 112 Colo. 573, 152 P.2d 682 (1944) (decided under repealed CSA, C. 112, § 68, negotiable instruments law).

IV. DELAY IN PRESENTMENT OR NOTICE.

Where presentment is not made on one of the makers primarily liable on the note, recovery cannot be had against the indorser. Prior v. Simonson, 62 Colo. 116, 160 P. 1035 (1916).

In case of a note secured by a chattel mortgage, the mortgagee, to preserve his lien against a third party, must make demand for payment of the mortgage debt within a reasonable time after maturity or take possession of the mortgaged property, which must be within a reasonable time; and on his failure thus to act, his lien will be postponed to that of a subsequent bona fide incumbrancer who levies upon it before the mortgagee takes possession. Metro. State Bank v. Wright, 72 Colo. 106, 209 P. 804 (1922).

Similarly, a check must be presented within a reasonable time, depending upon the circumstances. Babcock v. City of Rocky Ford, 25 Colo. App. 312, 137 P. 899 (1914).

One must make presentment on day received when he has knowledge of bank's failing circumstances. See Babcock v. City of Rocky Ford, 25 Colo. App. 312, 137 P. 899 (1914).

The failure of a subcontractor to present a check for payment within a reasonable time after issue does not discharge the liability of the prime contractor. Hoeppner Constr. Co. v. United States ex rel. Trautman & Shreve, Inc., 273 F.2d 835 (10th Cir. 1960).

V. DELAY IN PROTEST.

A bank's failure to make a formal protest is immaterial where one's liability is based not on his indorsement of a check, but on his status as depositor and withdrawer of the funds. Mercantile Bank & Trust Co. v. Hunter, 31 Colo. App. 200, 501 P.2d 486 (1972).

4-3-416. Transfer warranties. (a) A person who transfers an instrument for consideration warrants to the transferee and, if the transfer is by indorsement, to any subsequent transferee that:

(1) The warrantor is a person entitled to enforce the instrument;

(2) All signatures on the instrument are authentic and authorized;

(3) The instrument has not been altered;

(4) The instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor;

(5) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer; and

(6) If the instrument is a demand draft, creation of the instrument according to the terms on its face was authorized by the person identified as drawer. Nothing in this section shall be construed to impair the rights of the drawer against the drawee.

(b) A person to whom the warranties under subsection (a) of this section are made and who took the instrument in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach.

(c) The warranties stated in subsection (a) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within thirty days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (b) of this section is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(d) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(e) If the warranty in paragraph (6) of subsection (a) of this section is not given by a transferor under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee.

Source: L. 94: Entire article R&RE, p. 869, § 1, effective January 1, 1995. **L. 2001:** (a) amended and (e) added, p. 867, § 4, effective August 8.

Editor's note: This section is similar to former § 4-3-417 as it existed prior to 1994.

Cross references: For the legislative declaration contained in the 2001 act amending subsection (a) and enacting subsection (e), see section 1 of chapter 244, Session Laws of Colorado 2001.

OFFICIAL COMMENT

1. Subsection (a) is taken from subsection (2) of former Section 3-417. Subsections (3) and (4) of former Section 3-417 are deleted. Warranties under subsection (a) in favor of the immediate transferee apply to all persons who transfer an instrument for consideration whether or not the transfer is accompanied by indorsement. Any consideration sufficient to support a simple contract will support those warranties. If there is an indorsement the warranty runs with the instrument and the remote holder may sue the indorser-warrantor directly and thus avoid a multiplicity of suits.

2. Since the purpose of transfer (Section 3-203(a)) is to give the transferee the right to enforce the instrument, subsection (a)(1) is a warranty that the transferor is a person entitled to enforce the instrument (Section 3-301). Under Section 3-203(b) transfer gives the transferee any right of the transferor to enforce the instrument. Subsection (a)(1) is in effect a warranty that there are no unauthorized or missing indorsements that prevent the transferor from making the transferee a person entitled to enforce the instrument.

3. The rationale of subsection (a)(4) is that the transferee does not undertake to buy an instrument that is not enforceable in whole or in part, unless there is a contrary agreement. Even if the transferee takes as a holder in due course who takes free of the defense or claim in recoupment, the warranty gives the transferee the option of proceeding against the transferor rather than litigating with the obligor on the instrument the issue of the holder-in-due-course status of the transferee. Subsection (3) of former Section 3-417 which limits this warranty is deleted. The rationale is that while the purpose of a "no recourse" indorsement is to avoid a guaranty of payment, the indorsement does not clearly indicate an intent to disclaim warranties.

4. Under subsection (a)(5) the transferor does not warrant against difficulties of collection, impairment of the credit of the obligor or even insolvency. The transferee is expected to determine such questions before taking the obligation. If insolvency proceedings as defined in Section 1-201(22) have been instituted against the party who is expected to pay and the transferor knows it, the concealment of that fact amounts to a fraud upon the transferee, and the warranty against knowledge of such proceedings is provided accordingly.

5. Transfer warranties may be disclaimed with respect to any instrument except a check. Between the immediate parties disclaimer may be made by agreement. In the case of an indorser, disclaimer of transferor's liability, to be

effective, must appear in the indorsement with words such as "without warranties" or some other specific reference to warranties. But in the case of a check, subsection (c) of Section 3-416 provides that transfer warranties cannot be disclaimed at all. In the check collection process the banking system relies on these warranties.

6. Subsection (b) states the measure of damages for breach of warranty. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the phrase "expenses * * * incurred as a result of the breach." The intention is to leave to other state law the issue as to when attorney's fees are recoverable.

7. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" in subsection (d) have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

ANNOTATION

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

One negotiating an instrument warrants its genuineness, his good title, that all prior parties had capacity to contract, and he has no knowledge of any fact impairing its validity or rendering it valueless. Am. Nat'l Bank v. First Nat'l Bank, 130 Colo. 557, 277 P.2d 951 (1954) (decided under repealed CSA, C. 112, § 65, negotiable instruments law).

Payee may not maintain action against depositary bank. Nat'l Sur. Corp. v. Citizens State Bank, 41 Colo. App. 580, 593 P.2d 362 (1978), aff'd, 199 Colo. 497, 612 P.2d 70 (1980).

4-3-417. Presentment warranties. (a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee making payment or accepting the draft in good faith that:

(1) The warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) The draft has not been altered;

(3) The warrantor has no knowledge that the signature of the drawer of the draft is unauthorized; and

(4) If the draft is a demand draft, creation of the demand draft according to the terms on its face was authorized by the person identified as drawer. Nothing in this section shall be construed to impair the rights of the drawer against the drawee.

(b) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subsection (b).

(c) If a drawee asserts a claim for breach of warranty under subsection (a) of this section based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under section 4-3-404 or 4-3-405 or the drawer is precluded under section 4-3-406 or 4-4-406 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other instrument is presented for payment to a party obliged to pay the instrument, and (iii) payment is received, the following rules apply:

(1) The person obtaining payment and a prior transferor of the instrument warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor

transferred the instrument, a person entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce the instrument.

(2) The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subsections (a) and (d) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within thirty days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (b) or (d) of this section is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(g) A demand draft is a check, as provided in section 4-3-104 (f).

(h) If the warranty in paragraph (4) of subsection (a) of this section is not given by a transferor under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee.

Source: L. 94: Entire article R&RE, p. 869, § 1, effective January 1, 1995. **L. 2001:** (a) amended and (g) and (h) added, p. 867, § 5, effective August 8.

Editor's note: This section is similar to former § 4-3-417 as it existed prior to 1994.

Cross references: For the legislative declaration contained in the 2001 act amending subsection (a) and enacting subsections (g) and (h), see section 1 of chapter 244, Session Laws of Colorado 2001.

OFFICIAL COMMENT

1. This section replaces subsection (1) of former Section 3-417. The former provision was difficult to understand because it purported to state in one subsection all warranties given to any person paying any instrument. The result was a provision replete with exceptions that could not be readily understood except after close scrutiny of the language. In revised Section 3-417, presentment warranties made to drawees of uncertified checks and other unaccepted drafts are stated in subsection (a). All other presentment warranties are stated in subsection (d).

2. Subsection (a) states three warranties. Subsection (a)(1) in effect is a warranty that there are no unauthorized or missing indorsements. "Person entitled to enforce" is defined in Section 3-301. Subsection (a)(2) is a warranty that there is no alteration. Subsection (a)(3) is a warranty of no knowledge that there is a forged drawer's signature. Subsection (a) states that the warranties are made to the drawee and subsections (b) and (c) identify the drawee as the person entitled to recover for breach of warranty. There is no warranty made to the drawer under subsection (a) when presentment is made to the drawee. Warranty to the drawer is governed by subsection (d) and that applies only when presentment for payment is made to the drawer with respect to a dishonored draft. In **Sun 'N Sand, Inc. v. United California Bank,** 582 P.2d 920 (Cal. 1978), the court held that under former Section 3-417(1) a warranty was made to the drawer of a check when the check was presented to the drawee for payment. The result in that case is rejected.

3. Subsection (a)(1) retains the rule that the drawee does not admit the authenticity of indorsements and subsection (a)(3) retains the rule of **Price v. Neal,** 3 Burr. 1354 (1762), that the drawee takes the risk that the drawer's signature is unauthorized unless the person presenting the draft has knowledge that the drawer's signature is unauthorized. Under subsection (a)(3) the warranty of no knowledge that the drawer's signature is unauthorized is also given by prior transferors of the draft.

4. Subsection (d) applies to presentment for payment in all cases not covered by subsection (a). It applies to presentment of notes and accepted drafts to any party obliged to pay the instrument, including an indorser, and to presentment of dishonored drafts if made to the drawer or an indorser. In cases covered by subsection (d), there is only one warranty and it is the same as that stated in subsection (a)(1). There are no warranties comparable to subsections (a)(2) and (a)(3) because they are appropriate only in the case of presentment to the drawee of an unaccepted draft. With respect to presentment of an accepted draft to the acceptor, there is no warranty with respect to alteration or knowledge that the signature of the drawer is unauthorized. Those warranties were made to

the drawee when the draft was presented for acceptance (Section 3-417(a)(2) and (3)) and breach of that warranty is a defense to the obligation of the drawee as acceptor to pay the draft. If the drawee pays the accepted draft the drawee may recover the payment from any warrantor who was in breach of warranty when the draft was accepted. Section 3-417(b). Thus, there is no necessity for these warranties to be repeated when the accepted draft is presented for payment. Former Section 3-417(1)(b)(iii) and (c)(iii) are not included in revised Section 3-417 because they are unnecessary. Former Section 3-417(1)(c)(iv) is not included because it is also unnecessary. The acceptor should know what the terms of the draft were at the time acceptance was made.

If presentment is made to the drawer or maker, there is no necessity for a warranty concerning the signature of that person or with respect to alteration. If presentment is made to an indorser, the indorser had itself warranted authenticity of signatures and that the instrument was not altered. Section 3-416(a)(2) and (3).

5. The measure of damages for breach of warranty under subsection (a) is stated in subsection (b). There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses * * * resulting from the breach." Subsection (b) provides that the right of the drawee to recover for breach of warranty is not affected by a failure of the drawee to exercise ordinary care in paying the draft. This provision follows the result reached under former Article 3 in **Hartford Accident & Indemnity Co. v. First Pennsylvania Bank,** 859 F.2d 295 (3d Cir. 1988).

6. Subsection (c) applies to checks and other unaccepted drafts. It gives to the warrantor the benefit of rights that the drawee has against the drawer under Section 3-404, 3-405, 3-406, or 4-406. If the drawer's conduct contributed to a loss from forgery or alteration, the drawee should not be allowed to shift the loss from the drawer to the warrantor.

7. The first sentence of subsection (e) recognizes that checks are normally paid by automated means and that payor banks rely on warranties in making payment. Thus, it is not appropriate to allow disclaimer of warranties appearing on checks that normally will not be examined by the payor bank. The second sentence requires a breach of warranty claim to be asserted within 30 days after the drawee learns of the breach and the identity of the warrantor.

8. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" in subsection (f) have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

4-3-418. Payment or acceptance by mistake. (a) Except as provided in subsection (c) of this section, if the drawee of a draft pays or accepts the draft and the drawee acted on the mistaken belief that (i) payment of the draft had not been stopped pursuant to section 4-4-403 or (ii) the signature of the drawer of the draft was authorized, the drawee may recover the amount of the draft from the person to whom or for whose benefit payment was made or, in the case of acceptance, may revoke the acceptance. Rights of the drawee under this subsection are not affected by failure of the drawee to exercise ordinary care in paying or accepting the draft.

(b) Except as provided in subsection (c) of this section, if an instrument has been paid or accepted by mistake and the case is not covered by subsection (a) of this section, the person paying or accepting may, to the extent permitted by the law governing mistake and restitution, (i) recover the payment from the person to whom or for whose benefit payment was made or (ii) in the case of acceptance, may revoke the acceptance.

(c) The remedies provided by subsection (a) or (b) of this section may not be asserted against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. This subsection does not limit remedies provided by section 4-3-417 or 4-4-407.

(d) Notwithstanding section 4-4-215, if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under subsection (a) or (b) of this section, the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument.

Source: L. 94: Entire article R&RE, p. 871, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-418 as it existed prior to 1994.

OFFICIAL COMMENT

1. This section covers payment or acceptance by mistake and replaces former Section 3-418. Under former Article 3, the remedy of a drawee that paid or accepted a draft by mistake was based on the law of mistake and restitution, but that remedy was not specifically stated. It was provided by Section 1-103. Former Section 3-418 was simply a limitation on the unstated remedy under the law of mistake and restitution. Under revised Article 3, Section 3-418 specifically states the right of restitution in subsections (a) and (b). Subsection (a) allows restitution in the two most common cases in which the problem is presented: payment or acceptance of forged checks and checks on which the drawer has stopped payment. If the drawee acted under a mistaken belief that the check was not forged or had not been stopped, the drawee is entitled to recover the funds paid or to revoke the acceptance whether or not the drawee acted negligently. But in each case, by virtue of subsection (c), the drawee loses the remedy if the person receiving payment or acceptance was a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. Subsections (a) and (c) are consistent with former Section 3-418 and the rule of **Price v. Neal**. The result in the two cases covered by subsection (a) is that the drawee in most cases will not have a remedy against the person paid because there is usually a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance.

2. If a check has been paid by mistake and the payee receiving payment did not give value for the check or did not change position in reliance on the payment, the drawee bank is entitled to recover the amount of the check under subsection (a) regardless of how the check was paid. The drawee bank normally pays a check by a credit to an account of the collecting bank that presents the check for payment. The payee of the check normally receives the payment by a credit to the payee's account in the depositary bank. But in some cases the payee of the check may have received payment directly from the drawee bank by presenting the check for payment over the counter. In those cases the payee is entitled to receive cash, but the payee may prefer another form of payment such as a cashier's check or teller's check issued by the drawee bank. Suppose Seller contracted to sell goods to Buyer. The contract provided for immediate payment by Buyer and delivery of the goods 20 days after payment. Buyer paid by mailing a check for $10,000 drawn on Bank payable to Seller. The next day Buyer gave a stop payment order to Bank with respect to the check Buyer had mailed to Seller. A few days later Seller presented Buyer's check to Bank for payment over the counter and requested a cashier's check as payment. Bank issued and delivered a cashier's check for $10,000 payable to Seller. The teller failed to discover Buyer's stop order. The next day Bank discovered the mistake and immediately advised Seller of the facts. Seller refused to return the cashier's check and did not deliver any goods to Buyer.

Under Section 4-215, Buyer's check was paid by Bank at the time it delivered its cashier's check to Seller. See Comment 3 to Section 4-215. Bank is obliged to pay the cashier's check and has no defense to that obligation. The cashier's check was issued for consideration because it was issued in payment of Buyer's check. Although Bank has no defense on its cashier's check it may have a right to recover $10,000, the amount of Buyer's check, from Seller under Section 3-418(a). Bank paid Buyer's check by mistake. Seller did not give value for Buyer's check because the promise to deliver goods to Buyer was never performed. Section 3-303(a)(1). And, on these facts, Seller did not change position in reliance on the payment of Buyer's check. Thus, the first sentence of Section 3-418(c) does not apply and Seller is obliged to return $10,000 to Bank. Bank is obliged to pay the cashier's check but it has a counterclaim against Seller based on its rights under Section 3-418(a). This claim can be asserted against Seller, but it cannot be asserted against some other person with rights of a holder in due course of the cashier's check. A person without rights of a holder in due course of the cashier's check would take subject to Bank's claim against Seller because it is a claim in recoupment. Section 3-305(a)(3).

If Bank recovers from Seller under Section 3-418(a), the payment of Buyer's check is treated as unpaid and dishonored. Section 3-418(d). One consequence is that Seller may enforce Buyer's obligation as drawer to pay the check. Section 3-414. Another consequence is that Seller's rights against Buyer on the contract of sale are also preserved. Under Section 3-310(b) Buyer's obligation to pay for the goods was suspended when Seller took Buyer's check and remains suspended until the check is either dishonored or paid. Under Section 3-310(b)(1) the obligation is discharged when the check is paid. Since Section 3-418(d) treats Buyer's check as unpaid and dishonored, Buyer's obligation is not discharged and suspension of the obligation terminates. Under Section 3-310(b)(3), Seller may enforce either the contract of sale or the check subject to defenses and claims of Buyer.

If Seller had released the goods to Buyer before learning about the stop order, Bank would have no recovery against Seller under Section 3-418(a) because Seller in that case

gave value for Buyer's check. Section 3-418(c). In this case Bank's sole remedy is under Section 4-407 by subrogation.

3. Subsection (b) covers cases of payment or acceptance by mistake that are not covered by subsection (a). It directs courts to deal with those cases under the law governing mistake and restitution. Perhaps the most important class of cases that falls under subsection (b), because it is not covered by subsection (a), is that of payment by the drawee bank of a check with respect to which the bank has no duty to the drawer to pay either because the drawer has no account with the bank or because available funds in the drawer's account are not sufficient to cover the amount of the check. With respect to such a case, under Restatement of Restitution § 29, if the bank paid because of a mistaken belief that there were available funds in the drawer's account sufficient to cover the amount of the check, the bank is entitled to restitution. But § 29 is subject to Restatement of Restitution § 33 which denies restitution if the holder of the check receiving payment paid value in good faith for the check and had no reason to know that the check was paid by mistake when payment was received.

The result in some cases is clear. For example, suppose Father gives Daughter a check for $10,000 as a birthday gift. The check is drawn on Bank in which both Father and Daughter have accounts. Daughter deposits the check in her account in Bank. An employee of Bank, acting under the belief that there were available funds in Father's account to cover the check, caused Daughter's account to be credited for $10,000. In fact, Father's account was overdrawn and Father did not have overdraft privileges. Since Daughter received the check gratuitously there is clear unjust enrichment if she is allowed to keep the $10,000 and Bank is unable to obtain reimbursement from Father. Thus, Bank should be permitted to reverse the credit to Daughter's account. But this case is not typical. In most cases the remedy of restitution will not be available because the person receiving payment of the check will have given value for it in good faith.

In some cases, however, it may not be clear whether a drawee bank should have a right of restitution. For example, a check-kiting scheme may involve a large number of checks drawn on a number of different banks in which the drawer's credit balances are based on uncollected funds represented by fraudulently drawn checks. No attempt is made in Section 3-418 to state rules for determining the conflicting claims of the various banks that may be victimized by such a scheme. Rather, such cases are better resolved on the basis of general principles of law and the particular facts presented in the litigation.

4. The right of the drawee to recover a payment or to revoke an acceptance under Section 3-418 is not affected by the rules under Article 4 that determine when an item is paid. Even though a payor bank may have paid an item under Section 4-215, it may have a right to recover the payment under Section 3-418. **National Savings & Trust Co. v. Park Corp.,** 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S. 939 (1984), correctly states the law on the issue under former Article 3. Revised Article 3 does not change the previous law.

ANNOTATION

Section and comments, when read together with § 4-4-215 and comments, treat a cashier's check as the equivalent of cash and preclude issuing banks from dishonoring them at any time. Flatiron Linen, Inc. v. First Amer. State Bank, 23 P.3d 1209 (Colo. 2001).

Cashier's checks represent the unconditional obligation of the issuing bank to pay, and therefore, banks may not dishonor their cashier's checks once issued. Flatiron Linen, Inc. v. First Amer. State Bank, 23 P.3d 1209 (Colo. 2001).

Where payee took check as a refund for a loan commission and without knowledge of a stop payment order on the check, payee took the check for value and in good faith, and the drawee bank has no remedies against the payee for its mistaken payment of the check. Flatiron Linen, Inc. v. First Amer. State Bank, 23 P.3d 1209 (Colo. 2001).

4-3-419. Instruments signed for accommodation. (a) If an instrument is issued for value given for the benefit of a party to the instrument ("accommodated party") and another party to the instrument ("accommodation party") signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party "for accommodation."

(b) An accommodation party may sign the instrument as maker, drawer, acceptor, or indorser and, subject to subsection (d) of this section, is obliged to pay the instrument in the capacity in which the accommodation party signs. The obligation of an accommodation party may be enforced notwithstanding any statute of frauds and whether or not the accommodation party receives consideration for the accommodation.

(c) A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument. Except as provided in section 4-3-605, the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken by that person that the accommodation party signed the instrument for accommodation.

(d) If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if (i) execution of judgment against the other party has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the other party.

(e) An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the instrument against the accommodated party. An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party.

Source: L. 94: Entire article R&RE, p. 871, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-415 as it existed prior to 1994.

OFFICIAL COMMENT

1. Section 3-419 replaces former Sections 3-415 and 3-416. An accommodation party is a person who signs an instrument to benefit the accommodated party either by signing at the time value is obtained by the accommodated party or later, and who is not a direct beneficiary of the value obtained. An accommodation party will usually be a co-maker or anomalous indorser. Subsection (a) distinguishes between direct and indirect benefit. For example, if X cosigns a note of Corporation that is given for a loan to Corporation, X is an accommodation party if no part of the loan was paid to X or for X's direct benefit. This is true even though X may receive indirect benefit from the loan because X is employed by Corporation or is a stockholder of Corporation, or even if X is the sole stockholder so long as Corporation and X are recognized as separate entities.

2. It does not matter whether an accommodation party signs gratuitously either at the time the instrument is issued or after the instrument is in the possession of a holder. Subsection (b) of Section 3-419 takes the view stated in Comment 3 to former Section 3-415 that there need be no consideration running to the accommodation party: "The obligation of the accommodation party is supported by any consideration for which the instrument is taken before it is due. Subsection (2) is intended to change occasional decisions holding that there is no sufficient consideration where an accommodation party signs a note after it is in the hands of a holder who has given value. The [accommodation] party is liable to the holder in such a case even though there is no extension of time or other concession."

3. As stated in Comment 1, whether a person is an accommodation party is a question of fact. But it is almost always the case that a co-maker who signs with words of guaranty after the signature is an accommodation party. The same is true of an anomalous indorser. In either case a person taking the instrument is put on notice of the accommodation status of the co-maker or indorser. This is relevant to Section 3-605(h). But, under subsection (c), signing with words of guaranty or as an anomalous indorser also creates a presumption that the signer is an accommodation party. A party challenging accommodation party status would have to rebut this presumption by producing evidence that the signer was in fact a direct beneficiary of the value given for the instrument.

4. Subsection (b) states that an accommodation party is liable on the instrument in the capacity in which the party signed the instrument. In most cases that capacity will be either that of a maker or indorser of a note. But subsection (d) provides a limitation on subsection (b). If the signature of the accommodation party is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the instrument, liability is limited to that stated in subsection (d), which is based on former Section 3-416(2).

Former Article 3 was confusing because the obligation of a guarantor was covered both in

Section 3-415 and in Section 3-416. The latter section suggested that a signature accompanied by words of guaranty created an obligation distinct from that of an accommodation party. Revised Article 3 eliminates that confusion by stating in Section 3-419 the obligation of a person who uses words of guaranty. Portions of former Section 3-416 are preserved. Former Section 3-416(2) is reflected in Section 3-419(d) and former Section 3-416(4) is reflected in Section 3-419(c).

5. Subsection (e) restates subsection (5) of present Section 3-415. Since the accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party, the accommodation party also obtains rights to any security interest or other collateral that secures payment of the instrument.

ANNOTATION

Law reviews. For article, "Augmenting the Anomalousness of the Anomalous Indorser", see 16 Dicta 254 (1939).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Under the N.I.L. an accommodation party was one who signed the instrument as maker, drawer, acceptor, or indorser, without receiving value therefor, and for the purpose of lending his name to some other person; such person was liable on the instrument to a holder for value, though the holder, at the time of taking the instrument, knew him to be only an accommodation party. Foothills Holding Corp. v. Tulsa Rig, Reel & Mfg. Co., 155 Colo. 232, 393 P.2d 749 (1964).

One who signs a promissory note as surety is primarily liable on the instrument. Hall v. Farmers' Bank, 74 Colo. 165, 220 P. 237 (1923).

As distinguished from secondary liability. So far as concerns the holder of a note, the liability of a surety is a primary, as distinguished from a secondary, liability. Hall v. Farmers' Bank, 74 Colo. 165, 220 P. 237 (1923) (decided under repealed laws antecedent to CSA, C. 112, § 192, negotiable instruments law).

If one is an accommodation party lending his name, he is primarily liable to the holder, though he is merely a surety. Foothills Holding Corp. v. Tulsa Rig, Reel & Mfg. Co., 155 Colo. 232, 393 P.2d 749 (1964).

Where loan would not have been made save for third person's indorsement. Where a third person writes his name on the back of a note before delivery to the payee, and without such indorsement the loan evidenced by the note would not have been made, such third person is an original promisor with a primary obligation in an action by the payee. Court Valhalla No. 16 Foresters of Am. v. Olson, 14 Colo. App. 243, 59 P. 883 (1900).

Where maker of note obtains extension of obligation to repay a bank as result of an accommodation party's indorsement of a renewal note, the mere fact that accommodation indorsement is made at request of bank does not alter maker's position as beneficiary of the accommodation indorsement and as the party accommodated in transaction; and the accommodation party is liable as an accommodation indorser to a holder of the renewal note. State Bank v. Owens, 31 Colo. App. 351, 502 P.2d 965 (1972).

Liability of party signing note as individual, without qualifying designation. Where parties sign a note as individuals, without any qualifying designations, they are individually liable as makers, and not as accommodation parties. Rink-A-Dinks v. TNT Motorcycles, Inc., 655 P.2d 431 (Colo. App. 1982).

One who executes a note for the purpose of obtaining money for another and who receives no part of the fund for his personal use, the entire amount going to the accommodated party, is an accommodation party. McGhee Inv. Co. v. Kirsher, 71 Colo. 137, 204 P. 891 (1922). See Fleming v. Gamble, 37 F.2d 72 (10th Cir. 1929).

The term "value" as used in this section relates to value for the negotiable instrument and not to the loan of the name by way of accommodation. McGhee Inv. Co. v. Kirsher, 71 Colo. 137, 204 P. 891 (1922).

Moreover, comaker's answer that he received nothing of value for signing is no defense. In an action against several makers of a promissory note, the answer of one of them that he received nothing of value for signing it does not constitute a defense, because the consideration may have been received by his comakers. Bloom v. State Bank, 75 Colo. 28, 223 P. 750 (1924).

One who indorses a note prior to delivery: "Demand notice and protest waived. Payment guaranteed" is a surety or accommodation indorser within the meaning of this section. Winton v. Sullivan, 104 Colo. 450, 91 P.2d 996 (1939) (decided also under repealed CSA, C. 112, § 192, negotiable instruments law).

Even if it is conceded that a party is an accommodation maker, that fact does not do away with his responsibility for payment as fixed by this section. Civic Fin. Co. v. Meintzer, 137 Colo. 572, 328 P.2d 379 (1958).

Such an accommodation maker is liable as a maker upon the payee's suit. Torbit v. Heath, 11 Colo. App. 492, 53 P. 615 (1898).

Also, upon notes which one signs individually as an accommodation maker at the lender's request in order to obtain loans for a corporation of which he is an officer and principal stockholder, he is liable jointly and severally with the corporation for all amounts due upon the notes. Security Sav. & Loan Ass'n v. Colo. Real Estate Dev., Inc., 163 Colo. 155, 429 P.2d 288 (1967).

Stockholders who execute a promissory note to raise corporate funds cannot claim to be accommodation makers; rather, they are principal makers upon a sufficient consideration. Reed v. First Nat'l Bank, 23 Colo. 380, 48 P. 507 (1897).

An accommodation maker may proceed against principal maker. An accommodation maker or surety on a promissory note against whom a judgment has been rendered may, without making payment himself, proceed in equity against the principal makers, or their estate, for payment of the note so as to exonerate the surety. Woodward v. Hollis, 93 Colo. 17, 22 P.2d 862 (1933); Nat'l City Bank of Denver v. Sather, 677 P.2d 432 (Colo. App. 1983).

Where one of several accommodation indorsers pays the note indorsed, he is entitled to contribution. Owens v. Greenlee, 68 Colo. 114, 188 P. 721 (1920).

Though neither the law merchant nor the negotiable instruments act attempted to prescribe the rights of joint makers as between themselves; rather, these rights were left to be settled according to the principles of the common law and the equities between the parties. Owens v. Greenlee, 68 Colo. 114, 188 P. 721 (1920).

A guaranty is to be reasonably interpreted according to the intention of the parties as disclosed by facts and circumstances surrounding its execution. Valley Nat'l Bank v. Foreign Car Rental, Inc., 404 P.2d 272 (1965); First Interstate Bank v. Colcott Partners, 833 P.2d 876 (Colo. App. 1992).

Guaranty agreements must be strictly construed in favor of the guarantor. Walter E. Heller & Co. v. Wilkerson, 627 P.2d 773 (Colo. App. 1980); First Interstate Bank v. Colcott Partners, 833 P.2d 876 (Colo. App. 1992).

Guarantor's liability is separate and independent of and not affected by validity of stipulated settlement agreement. Defendants' claim that the settlement agreement was based upon a mistake of fact and should be set aside had no bearing on the validity of the unconditional guaranty. First Interstate Bank v. Colcott Partners, 833 P.2d 876 (Colo. App. 1992).

Guarantor's liability is the same as that of principal debtor where there is no language to the contrary in the guaranty. First Interstate Bank v. Colcott Partners, 833 P.2d 876 (Colo. App. 1992).

Where a contract of guaranty provides that notice of default of the principal debtor must be given to the guarantor, such notice must be given for the guarantor to be liable. Western States Leasing Co. v. Adturn, Inc., 31 Colo. App. 256, 500 P.2d 1190 (1972).

However, where an unambiguous absolute guaranty is silent as to notice and the maximum amount guaranteed is determinable at the time the guarantee is entered into, there is no basis to imply a requirement of notice. Western States Leasing Co. v. Adturn, Inc., 31 Colo. App. 256, 500 P.2d 1190 (1972).

It is error to resort to another instrument for any limiting conditions. Where separate instrument guarantying lease payment is unambiguous, it is error to resort to the language of the lease to construe the guaranty as to any limiting conditions. Western States Leasing Co. v. Adturn, Inc., 31 Colo. App. 256, 500 P.2d 1190 (1972).

Same person may be both guarantor and indorser. Winton v. Sullivan, 104 Colo. 450, 91 P.2d 996 (1939).

A guarantor of a note is not an indorser within the meaning of that term as used in a warrant of attorney in such note; hence, a judgment rendered upon confession thereunder is void for lack of jurisdiction of the person. Sidwell v. First Nat'l Bank, 76 Colo. 547, 233 P. 153 (1925) (decided under repealed laws antecedent to CSA, C. 112, § 29, negotiable instruments law).

Guarantor is secondarily liable. For the one who after the execution and delivery of a promissory note signs it as guarantor to satisfy a subsequent purchaser, his liability thereon is secondary and not primary. Cobbey v. Peterson, 89 Colo. 350, 3 P.2d 298 (1931) (decided under repealed laws antecedent to CSA, C. 112, § 192, negotiable instruments law).

Liability of a guarantor of negotiable paper was not fixed by the N.I.L. Winton v. Sullivan, 104 Colo. 450, 91 P.2d 996 (1939).

Under subsection (c), the lack of qualifying words on promissory note cannot defeat accommodation party status. Accordingly, because no such qualifiers are present, court looks for evidence showing that individual defendants received a direct benefit from the value given for promissory note. Park County Bd. of County Comm'rs v. Park County Sportsmen's Ranch, LLP, 271 P.3d 562 (Colo. App. 2011).

Because evidence does not show that individual defendants received a direct benefit from either original loan or subsequent promissory note, court of appeals must overturn jury's finding that defendants did not sign as accommodation parties. Here, individual defendants were accommodation parties. As accommodation parties, individual defendants were entitled to enforce note and their acquisition of the note did not extinguish underlying

deed of trust. Park County Bd. of County Comm'rs v. Park County Sportsmen's Ranch, LLP, 271 P.3d 562 (Colo. App. 2011).

4-3-420. Conversion of instrument. (a) The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by (i) the issuer or acceptor of the instrument or (ii) a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a co-payee.

(b) In an action under subsection (a) of this section, the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument.

(c) A representative, other than a depositary bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not the person entitled to enforce the instrument is not liable in conversion to that person beyond the amount of any proceeds that it has not paid out.

Source: L. 94: Entire article R&RE, p. 872, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-419 as it existed prior to 1994.

OFFICIAL COMMENT

1. Section 3-420 is a modification of former Section 3-419. The first sentence of Section 3-420(a) states a general rule that the law of conversion applicable to personal property also applies to instruments. Paragraphs (a) and (b) of former Section 3-419(1) are deleted as inappropriate in cases of noncash items that may be delivered for acceptance or payment in collection letters that contain varying instructions as to what to do in the event of nonpayment on the day of delivery. It is better to allow such cases to be governed by the general law of conversion that would address the issue of when, under the circumstances prevailing, the presenter's right to possession has been denied. The second sentence of Section 3-420(a) states that an instrument is converted if it is taken by transfer other than a negotiation from a person not entitled to enforce the instrument or taken for collection or payment from a person not entitled to enforce the instrument or receive payment. This covers cases in which a depositary or payor bank takes an instrument bearing a forged indorsement. It also covers cases in which an instrument is payable to two persons and the two persons are not alternative payees, e.g. a check payable to John and Jane Doe. Under Section 3-110(d) the check can be negotiated or enforced only by both persons acting jointly. Thus, neither payee acting without the consent of the other, is a person entitled to enforce the instrument. If John indorses the check and Jane does not, the indorsement is not effective to allow negotiation of the check. If Depositary Bank takes the check for deposit to John's account, Depositary Bank is liable to Jane for conversion of the check if she did not consent to the transaction. John, acting alone, is not the person entitled to enforce the check because John is not the holder of the check. Section 3-110(d) and Comment 4 to Section 3-110. Depositary Bank does not get any greater rights under Section 4-205(1). If it acted for John as its customer, it did not become holder of the check under that provision because John, its customer, was not a holder.

Under former Article 3, the cases were divided on the issue of whether the drawer of a check with a forged indorsement can assert rights against a depositary bank that took the check. The last sentence of Section 3-420(a) resolves the conflict by following the rule stated in **Stone & Webster Engineering Corp. v. First National Bank & Trust Co.,** 184 N.E.2d 358 (Mass. 1962). There is no reason why a drawer should have an action in conversion. The check represents an obligation of the drawer rather than property of the drawer. The drawer has an adequate remedy against the payor bank for recredit of the drawer's account for unauthorized payment of the check.

There was also a split of authority under former Article 3 on the issue of whether a payee who never received the instrument is a proper plaintiff in a conversion action. The typical case was one in which a check was stolen from the drawer or in which the check was mailed to an address different from that of the payee and was stolen after it arrived at that address. The thief

forged the indorsement of the payee and obtained payment by depositing the check to an account in a depositary bank. The issue was whether the payee could bring an action in conversion against the depositary bank or the drawee bank. In revised Article 3, under the last sentence of Section 3-420(a), the payee has no conversion action because the check was never delivered to the payee. Until delivery, the payee does not have any interest in the check. The payee never became the holder of the check nor a person entitled to enforce the check. Section 3-301. Nor is the payee injured by the fraud. Normally the drawer of a check intends to pay an obligation owed to the payee. But if the check is never delivered to the payee, the obligation owed to the payee is not affected. If the check falls into the hands of a thief who obtains payment after forging the signature of the payee as an indorsement, the obligation owed to the payee continues to exist after the thief receives payment. Since the payee's right to enforce the underlying obligation is unaffected by the fraud of the thief, there is no reason to give any additional remedy to the payee. The drawer of the check has no conversion remedy, but the drawee is not entitled to charge the drawer's account when the drawee wrongfully honored the check. The remedy of the drawee is against the depositary bank for breach of warranty under Section 3-417(a)(1) or 4-208(a)(1). The loss will fall on the person who gave value to the thief for the check.

The situation is different if the check is delivered to the payee. If the check is taken for an obligation owed to the payee, the last sentence of Section 3-310(b)(4) provides that the obligation may not be enforced to the extent of the amount of the check. The payee's rights are restricted to enforcement of the payee's rights in the instrument. In this event the payee is injured by the theft and has a cause of action for conversion.

The payee receives delivery when the check comes into the payee's possession, as for example when it is put into the payee's mailbox. Delivery to an agent is delivery to the payee. If a check is payable to more than one payee, delivery to one of the payees is deemed to be delivery to all of the payees. Occasionally, the person asserting a conversion cause of action is an indorsee rather than the original payee. If the check is stolen before the check can be delivered to the indorsee and the indorsee's indorsement is forged, the analysis is similar. For example, a check is payable to the order of A. A indorses it to B and puts it into an envelope addressed to B. The envelope is never delivered to B. Rather, Thief steals the envelope, forges B's indorsement to the check and obtains payment. Because the check was never delivered to B, the indorsee, B has no cause of action for conversion, but A does have such an action. A is the owner of the check. B never obtained rights in the check. If A intended to negotiate the check to B in payment of an obligation, that obligation was not affected by the conduct of Thief. B can enforce that obligation. Thief stole A's property not B's.

2. Subsection (2) of former Section 3-419 is amended because it is not clear why the former law distinguished between the liability of the drawee and that of other converters. Why should there be a conclusive presumption that the liability is face amount if a drawee refuses to pay or return an instrument or makes payment on a forged indorsement, while the liability of a maker who does the same thing is only presumed to be the face amount? Moreover, it was not clear under former Section 3-419(2) what face amount meant. If a note for $10,000 is payable in a year at 10% interest, it is common to refer to $10,000 as the face amount, but if the note is converted the loss to the owner also includes the loss of interest. In revised Article 3, Section 3-420(b), by referring to "amount payable on the instrument," allows the full amount due under the instrument to be recovered.

The "but" clause in subsection (b) addresses the problem of conversion actions in multiple payee checks. Section 3-110(d) states that an instrument cannot be enforced unless all payees join in the action. But an action for conversion might be brought by a payee having no interest or a limited interest in the proceeds of the check. This clause prevents such a plaintiff from receiving a windfall. An example is a check payable to a building contractor and a supplier of building material. The check is not payable to the payees alternatively. Section 3-110(d). The check is delivered to the contractor by the owner of the building. Suppose the contractor forges supplier's signature as an indorsement of the check and receives the entire proceeds of the check. The supplier should not, without qualification, be able to recover the entire amount of the check from the bank that converted the check. Depending upon the contract between the contractor and the supplier, the amount of the check may be due entirely to the contractor, in which case there should be no recovery, entirely to the supplier, in which case recovery should be for the entire amount, or part may be due to one and the rest to the other, in which case recovery should be limited to the amount due to the supplier.

3. Subsection (3) of former Section 3-419 drew criticism from the courts, that saw no reason why a depositary bank should have the defense stated in the subsection. See **Knesz v. Central Jersey Bank & Trust Co.,** 477 A.2d 806 (N.J. 1984). The depositary bank is ultimately liable in the case of a forged indorsement check because of its warranty to the payor bank under Section 4-208(a)(1) and it is usually the most convenient defendant in cases involving

multiple checks drawn on different banks. There is no basis for requiring the owner of the check to bring multiple actions against the various payor banks and to require those banks to assert warranty rights against the depositary bank. In revised Article 3, the defense provided by Section 3-420(c) is limited to collecting banks other than the depositary bank. If suit is brought against both the payor bank and the depositary bank, the owner, of course, is entitled to but one recovery.

ANNOTATION

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Elements of conversion. There is a conversion of a negotiable instrument when any person unlawfully takes, detains, or refuses to surrender a negotiable instrument belonging to another person. Commercial Credit Corp. v. Univ. Nat'l Bank, 590 F.2d 849 (10th Cir. 1979).

While a showing of fraud, misrepresentation, or mistake may constitute a defense to payment, it does not establish the right to immediate possession, a necessary prerequisite to establishing a claim for conversion. Commercial Credit Corp. v. Univ. Nat'l Bank, 590 F.2d 849 (10th Cir. 1979).

Bank's wrongful deposit of corporate checks into treasurer's personal account, absent commercially reasonable inquiries as to the authority of the treasurer to deposit such checks, constitutes conversion. Central Inc. v. Cache Nat'l Bank, 748 P.2d 351 (Colo. App. 1987).

If payment by a collecting or depository bank occurs on a check with no indorsement or with a missing endorsement, it is the legal equivalent of payment on a forged indorsement, which constitutes conversion. Central Inc. v. Cache Nat'l Bank, 748 P.2d 351 (Colo. App. 1987).

Common-law recognized right of payee to maintain action for conversion against bank under circumstances where the bank wrongfully paid out moneys based upon a forged endorsement. Citizens State Bank v. Nat'l Sur. Corp., 199 Colo. 497, 612 P.2d 70 (1980).

Adoption of this section has not altered the law in Colorado by abolishing the common-law payee's conversion action against a depositary bank that has cashed a check upon a forged endorsement. Nat'l Sur. Corp. v. Citizens State Bank, 41 Colo. App. 580, 593 P.2d 362 (1978), aff'd, 199 Colo. 497, 612 P.2d 70 (1980).

Former version of subsection (1) not all inclusive. The three listed situations in subsection (1) of this section are not meant to be exclusive examples of actionable conversion. Commercial Credit Corp. v. Univ. Nat'l Bank, 590 F.2d 849 (10th Cir. 1979).

Purpose of former version of subsection (3) was to create an affirmative defense which a defendant-bank may assert. Citizens State Bank v. Nat'l Sur. Corp., 199 Colo. 497, 612 P.2d 70 (1980).

Where undisputed evidence established that collecting bank failed to make inquiries as to the authority of a corporate treasurer to deposit checks payable to corporation into the personal account of the treasurer, the court properly determined that the bank had not acted according to reasonable commercial standards and was not entitled to take advantage of the statutory defenses. Central Inc. v. Cache Nat'l Bank, 748 P.2d 351 (Colo. App. 1987).

The affirmative defense was not available to bank which paid checks without any indorsement. The bank as a matter of law did not act in accordance with reasonable commercial standards in handling the checks without the payee's signature. Kelly v. Central Bank and Trust Co., 794 P.2d 1037 (Colo. App. 1989).

Phrase "or otherwise" in former version of subsection (3) only has meaning if the drafters anticipated a cause of action other than conversion, e.g., an action for moneys had and received. Citizens State Bank v. Nat'l Sur. Corp., 199 Colo. 497, 612 P.2d 70 (1980).

Applied in Nat'l Sur. Corp. v. Citizens State Bank, 651 P.2d 460 (Colo. App. 1982).

PART 5

DISHONOR

4-3-501. Presentment. (a) "Presentment" means a demand made by or on behalf of a person entitled to enforce an instrument (i) to pay the instrument made to the drawee or a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, to the bank, or (ii) to accept a draft made to the drawee.

(b) The following rules are subject to article 4 of this title, agreement of the parties, and clearing-house rules and the like:

(1) Presentment may be made at the place of payment of the instrument and must be made at the place of payment if the instrument is payable at a bank in the United States; may be made by any commercially reasonable means, including an oral, written, or electronic communication; is effective when the demand for payment or acceptance is received by the person to whom presentment is made; and is effective if made to any one of two or more makers, acceptors, drawees, or other payors.

(2) Upon demand of the person to whom presentment is made, the person making presentment must (i) exhibit the instrument, (ii) give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so, and (iii) sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made.

(3) Without dishonoring the instrument, the party to whom presentment is made may (i) return the instrument for lack of a necessary indorsement, or (ii) refuse payment or acceptance for failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule.

(4) The party to whom presentment is made may treat presentment as occurring on the next business day after the day of presentment if the party to whom presentment is made has established a cut-off hour not earlier than 2 p.m. for the receipt and processing of instruments presented for payment or acceptance and presentment is made after the cut-off hour.

Source: L. 94: Entire article R&RE, p. 873, § 1, effective January 1, 1995.

Editor's note: This section is similar to former §§ 4-3-501, 4-3-503, and 4-3-504 as they existed prior to 1994.

OFFICIAL COMMENT

Subsection (a) defines presentment. Subsection (b)(1) states the place and manner of presentment. Electronic presentment is authorized. The communication of the demand for payment or acceptance is effective when received. Subsection (b)(2) restates former Section 3-505. Subsection (b)(2)(i) allows the person to whom presentment is made to require exhibition of the instrument, unless the parties have agreed otherwise as in an electronic presentment agreement. Former Section 3-507(3) is the antecedent of subsection (b)(3)(i). Since a payor must decide whether to pay or accept on the day of presentment, subsection (b)(4) allows the payor to set a cut-off hour for receipt of instruments presented.

ANNOTATION

Law reviews. For comment on Colorado Nat'l Bank v. David appearing below, see 4 Rocky Mt. L. Rev. 289 (1932).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Under this section a check need not be presented for acceptance unless it contains an express stipulation to that effect. Van Buskirk v. State Bank, 35 Colo. 142, 83 P. 778 (1905).

Likewise, a bondholder is not required to present a bond or interest coupons for payment at maturity in order to fix the absolute liability of the maker, and this fact is true even though such is made payable at a particular bank where the maker has deposited funds to meet the obligations and the bank fails subsequent to the maturity of the bonds. Employers Mut. Ins. Co. v. Bd. of County Comm'rs, 102 Colo. 177, 78 P.2d 380 (1938).

To charge an indorser, presentment for payment and notice to him of the dishonor must be alleged and shown. Sykes v. Kruse, 49 Colo. 560, 113 P. 1013 (1911).

Which can be urged on appeal. Substantial defects may be urged on appeal though not presented in the court below, e.g., failure, as against the indorser of negotiable paper to allege presentment for payment and notice of dishonor. Sykes v. Kruse, 49 Colo. 560, 113 P. 1013 (1911).

Such does not apply to suits between accommodation indorsers. In a suit in equity by one of several accommodation indorsers against the others for contribution, the defendants will not be heard to contend that they were entitled to notice of the dishonor and protest of the bill, as the provisions of this section have no application in such case. Owens v. Greenlee, 68 Colo. 114, 188 P. 721 (1920).

In an action on a note payable at a specified place, a demand need not be averred or proved; and, if the maker was ready and offered at the time and place to pay it, this is a matter of defense to be pleaded and proved by him. Florence Oil & Ref. Co. v. First Nat'l Bank, 38 Colo. 119, 88 P. 182 (1906).

Notice to one does not constitute notice to all. In an action on a promissory note, notice of nonpayment to one defendant does not constitute notice to the others, and the contention that he is the general agent of his codefendants for the purpose of receiving notice is without merit. Bieser v. Irwin, 101 Colo. 210, 72 P.2d 271 (1937).

Where stolen check bore a 1971 date and was not cashed until 1973, when the time for presentment had long since passed, the lack of timely presentment would not have destroyed its negotiability as the negotiability of an instrument is not affected by the fact that it is undated, antedated, or postdated. Thus, the stolen check indorsed by accused falls squarely within the terms of the forgery statute under which he was convicted. People v. Palmer, 189 Colo. 358, 540 P.2d 341 (1975).

Unless negotiable paper is sent by the holder for collection from the maker to the very bank designated as the place of payment, such bank is the agent of the maker and not of the holder in relation to any deposit by the maker when there is no evidence of an express authority. Employers Mut. Ins. Co. v. Bd. of County Comm'rs, 102 Colo. 177, 78 P.2d 380 (1938).

Where a promissory note payable at a certain bank is there presented on the day of its maturity, but payment is refused, and the holder then presents it at the maker's place of business, but payment is likewise refused, his leaving such at the bank immediately thereafter is a good presentment. Archuleta v. Johnston, 53 Colo. 393, 127 P. 134 (1912).

A bondholder is not required to present a bond or interest coupons for payment at maturity in order to fix the absolute liability of the maker, and this is true even though the paper is made payable at a particular bank where the maker has deposited sufficient funds to meet his obligation and the bank has failed subsequent to the maturity of the paper. Employers Mut. Ins. Co. v. Bd. of County Comm'rs, 102 Colo. 177, 78 P.2d 380 (1938).

To charge the indorser of a promissory note, executed by two or more persons not partners, no place of payment being specified, presentment for payment must be made to each of the makers. Prior v. Simonson, 62 Colo. 116, 160 P. 1035 (1916).

Where payee pledges a note without the maker's knowledge, and the individual who assumes the note pays all interest to the payee with the pledgee's acquiescence, the payment of the principal to the payee is a defense against the pledgee. Colo. Nat'l Bank v. David, 89 Colo. 238, 1 P.2d 578 (1931).

A note drawn to alternative, not joint, payees can be discharged only by a holder of the instrument. Reese v. Lietzan, 160 Colo. 253, 419 P.2d 959 (1966).

Applied in Genua v. Kilmer, 37 Colo. App. 365, 546 P.2d 1279 (1976).

4-3-502. Dishonor. (a) Dishonor of a note is governed by the following rules:

(1) If the note is payable on demand, the note is dishonored if presentment is duly made to the maker and the note is not paid on the day of presentment.

(2) If the note is not payable on demand and is payable at or through a bank or the terms of the note require presentment, the note is dishonored if presentment is duly made and the note is not paid on the day it becomes payable or the day of presentment, whichever is later.

(3) If the note is not payable on demand and paragraph (2) of this subsection (a) does not apply, the note is dishonored if it is not paid on the day it becomes payable.

(b) Dishonor of an unaccepted draft other than a documentary draft is governed by the following rules:

(1) If a check is duly presented for payment to the payor bank otherwise than for immediate payment over the counter, the check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment under section 4-4-301 or 4-4-302, or becomes accountable for the amount of the check under section 4-4-302.

(2) If a draft is payable on demand and paragraph (1) of this subsection (b) does not apply, the draft is dishonored if presentment for payment is duly made to the drawee and the draft is not paid on the day of presentment.

(3) If a draft is payable on a date stated in the draft, the draft is dishonored if (i) presentment for payment is duly made to the drawee and payment is not made on the day the draft becomes payable or the day of presentment, whichever is later, or (ii) presentment for acceptance is duly made before the day the draft becomes payable and the draft is not accepted on the day of presentment.

(4) If a draft is payable on elapse of a period of time after sight or acceptance, the draft is dishonored if presentment for acceptance is duly made and the draft is not accepted on the day of presentment.

(c) Dishonor of an unaccepted documentary draft occurs according to the rules stated in subsection (b) (2), (3), and (4) of this section, except that payment or acceptance may be delayed without dishonor until no later than the close of the third business day of the drawee following the day on which payment or acceptance is required by those paragraphs.

(d) Dishonor of an accepted draft is governed by the following rules:

(1) If the draft is payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and the draft is not paid on the day of presentment.

(2) If the draft is not payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and payment is not made on the day it becomes payable or the day of presentment, whichever is later.

(e) In any case in which presentment is otherwise required for dishonor under this section and presentment is excused under section 4-3-504, dishonor occurs without presentment if the instrument is not duly accepted or paid.

(f) If a draft is dishonored because timely acceptance of the draft was not made and the person entitled to demand acceptance consents to a late acceptance, from the time of acceptance the draft is treated as never having been dishonored.

Source: L. 94: Entire article R&RE, p. 873, § 1, effective January 1, 1995.

Editor's note: This section is similar to former §§ 4-3-501 and 4-3-507 as they existed prior to 1994.

OFFICIAL COMMENT

1. Section 3-415 provides that an indorser is obliged to pay an instrument if the instrument is dishonored and is discharged if the indorser is entitled to notice of dishonor and notice is not given. Under Section 3-414, the drawer is obliged to pay an unaccepted draft if it is dishonored. The drawer, however, is not entitled to notice of dishonor except to the extent required in a case governed by Section 3-414(d). Part 5 tells when an instrument is dishonored (Section 3-502) and what it means to give notice of dishonor (Section 3-503). Often dishonor does not occur until presentment (Section 3-501), and frequently presentment and notice of dishonor are excused (Section 3-504).

2. In the great majority of cases presentment and notice of dishonor are waived with respect to notes. In most cases a formal demand for payment to the maker of the note is not contemplated. Rather, the maker is expected to send payment to the holder of the note on the date or dates on which payment is due. If payment is not made when due, the holder usually makes a demand for payment, but in the normal case in which presentment is waived, demand is irrelevant and the holder can proceed against indorsers when payment is not received. Under former Article 3, in the small minority of cases in which presentment and dishonor were not waived with respect to notes, the indorser was discharged from liability (former Section 3-502(1)(a)) unless the holder made presentment to the maker on the exact day the note was due (former Section 3-503(1)(c)) and gave notice of dishonor to the indorser before midnight of the third business day after dishonor (former Section 3-508(2)). These provisions are omitted from Revised Article 3 as inconsistent with practice which seldom involves face-to-face dealings.

3. Subsection (a) applies to notes. Subsection (a)(1) applies to notes payable on demand. Dishonor requires presentment, and dishonor occurs if payment is not made on the day of presentment. There is no change from previous Article 3. Subsection (a)(2) applies to notes payable at a definite time if the note is payable at or through a bank or, by its terms, presentment is required. Dishonor requires presentment, and dishonor occurs if payment is not made on the due date or the day of presentment if presentment is made after the due date. Subsection (a)(3) applies to all other notes. If the note is not paid on its due date it is dishonored. This allows holders to collect notes in ways that make sense commercially without having to be concerned about a formal presentment on a given day.

4. Subsection (b) applies to unaccepted drafts other than documentary drafts. Subsection (b)(1) applies to checks. Except for checks presented for immediate payment over the counter, which are covered by subsection (b)(2), dishonor occurs according to rules stated in Article 4. When a check is presented for payment through the check-collection system, the drawee

bank normally makes settlement for the amount of the check to the presenting bank. Under Section 4-301 the drawee bank may recover this settlement if it returns the check within its midnight deadline (Section 4-104). In that case the check is not paid and dishonor occurs under Section 3-502(b)(1). If the drawee bank does not return the check or give notice of dishonor or nonpayment within the midnight deadline, the settlement becomes final payment of the check. Section 4-215. Thus, no dishonor occurs regardless of whether the check is retained or is returned after the midnight deadline. In some cases the drawee bank might not settle for the check when it is received. Under Section 4-302 if the drawee bank is not also the depositary bank and retains the check without settling for it beyond midnight of the day it is presented for payment, the bank becomes "accountable" for the amount of the check, i.e. it is obliged to pay the amount of the check. If the drawee bank is also the depositary bank, the bank is accountable for the amount of the check if the bank does not pay the check or return it or send notice of dishonor within the midnight deadline. In all cases in which the drawee bank becomes accountable, the check has not been paid and, under Section 3-502(b)(1), the check is dishonored. The fact that the bank is obliged to pay the check does not mean that the check has been paid. When a check is presented for payment, the person presenting the check is entitled to payment not just the obligation of the drawee to pay. Until that payment is made, the check is dishonored. To say that the drawee bank is obliged to pay the check necessarily means that the check has not been paid. If the check is eventually paid, the drawee bank no longer is accountable.

Subsection (b)(2) applies to demand drafts other than those governed by subsection (b)(1). It covers checks presented for immediate payment over the counter and demand drafts other than checks. Dishonor occurs if presentment for payment is made and payment is not made on the day of presentment.

Subsection (b)(3) and (4) applies to time drafts. An unaccepted time draft differs from a time note. The maker of a note knows that the note has been issued, but the drawee of a draft may not know that a draft has been drawn on it. Thus, with respect to drafts, presentment for payment or acceptance is required. Subsection (b)(3) applies to drafts payable on a date stated in the draft. Dishonor occurs if presentment for payment is made and payment is not made on the day the draft becomes payable or the day of presentment if presentment is made after the due date. The holder of an unaccepted draft payable on a stated date has the option of presenting the draft for acceptance before the day the draft becomes payable to establish whether the drawee is willing to assume liability by accepting. Under subsection (b)(3)(ii) dishonor occurs when the draft is presented and not accepted. Subsection (b)(4) applies to unaccepted drafts payable on elapse of a period of time after sight or acceptance. If the draft is payable 30 days after sight, the draft must be presented for acceptance to start the running of the 30-day period. Dishonor occurs if it is not accepted. The rules in subsection (b)(3) and (4) follow former Section 3-501(1)(a).

5. Subsection (c) gives drawees an extended period to pay documentary drafts because of the time that may be needed to examine the documents. The period prescribed is that given by Section 5-112 in cases in which a letter of credit is involved.

6. Subsection (d) governs accepted drafts. If the acceptor's obligation is to pay on demand the rule, stated in subsection (d)(1), is the same as for that of a demand note stated in subsection (a)(1). If the acceptor's obligation is to pay at a definite time the rule, stated in subsection (d)(2), is the same as that of a time note payable at a bank stated in subsection (b)(2).

7. Subsection (e) is a limitation on subsection (a)(1) and (2), subsection (b), subsection (c), and subsection (d). Each of those provisions states dishonor as occurring after presentment. If presentment is excused under Section 3-504, dishonor occurs under those provisions without presentment if the instrument is not duly accepted or paid.

8. Under subsection (b)(3)(ii) and (4) if a draft is presented for acceptance and the draft is not accepted on the day of presentment, there is dishonor. But after dishonor, the holder may consent to late acceptance. In that case, under subsection (f), the late acceptance cures the dishonor. The draft is treated as never having been dishonored. If the draft is subsequently presented for payment and payment is refused dishonor occurs at that time.

4-3-503. Notice of dishonor. (a) The obligation of an indorser stated in section 4-3-415 (a) and the obligation of a drawer stated in section 4-3-414 (d) may not be enforced unless (i) the indorser or drawer is given notice of dishonor of the instrument complying with this section or (ii) notice of dishonor is excused under section 4-3-504 (b).

(b) Notice of dishonor may be given by any person; may be given by any commercially reasonable means, including an oral, written, or electronic communication; and is sufficient if it reasonably identifies the instrument and indicates that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor.

(c) Subject to section 4-3-504 (c), with respect to an instrument taken for collection by a collecting bank, notice of dishonor must be given (i) by the bank before midnight of the next banking day following the banking day on which the bank receives notice of dishonor of the instrument, or (ii) by any other person within thirty days following the day on which the person receives notice of dishonor. With respect to any other instrument, notice of dishonor must be given within thirty days following the day on which dishonor occurs.

Source: L. 94: Entire article R&RE, p. 875, § 1, effective January 1, 1995.

Editor's note: This section is similar to former §§ 4-3-501, 4-3-508, and 4-3-510 as they existed prior to 1994.

OFFICIAL COMMENT

1. Subsection (a) is consistent with former Section 3-501(2)(a), but notice of dishonor is no longer relevant to the liability of a drawer except for the case of a draft accepted by an acceptor other than a bank. Comments 2 and 4 to Section 3-414. There is no reason why drawers should be discharged on instruments they draw until payment or acceptance. They are entitled to have the instrument presented to the drawee and dishonored (Section 3-414(b)) before they are liable to pay, but no notice of dishonor need be made to them as a condition of liability. Subsection (b), which states how notice of dishonor is given, is based on former Section 3-508(3).

2. Subsection (c) replaces former Section 3-508(2). It differs from that section in that it provides a 30-day period for a person other than a collecting bank to give notice of dishonor rather than the three-day period allowed in former Article 3. Delay in giving notice of dishonor may be excused under Section 3-504(c).

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Oral notice is sufficient. De La Vergne v. Globe Printing Co., 27 Colo. App. 308, 148 P. 923 (1915).

Such notice within two days held in due time where parties resided in different places. De La Vergne v. Globe Printing Co., 27 Colo. App. 308, 148 P. 923 (1915).

Notice of dishonor made on the day of dishonor and addressed to the indorser at a place which the indorser named as his residence at the time of the execution of the note is sufficient, since the payee is entitled to rely on such statement. Archuleta v. Johnston, 53 Colo. 393, 127 P. 134 (1912).

Delay in giving notice of dishonor to an antecedent party while investigating an apparent erasure of the party's name on the paper is not excused. Emerson & Buckingham Bank & Trust Co. v. German-American Trust Co., 65 Colo. 398, 176 P. 472 (1918).

4-3-504. Excused presentment and notice of dishonor. (a) Presentment for payment or acceptance of an instrument is excused if (i) the person entitled to present the instrument cannot with reasonable diligence make presentment, (ii) the maker or acceptor has obligation to pay the instrument or is dead or in insolvency proceedings, (iii) by the terms of the instrument presentment is not necessary to enforce the obligation of indorsers or the drawer, (iv) the drawer or indorser whose obligation is being enforced has waived presentment or otherwise has no reason to expect or right to require that the instrument be paid or accepted, or (v) the drawer instructed the drawee not to pay or accept the draft or the drawee was not obligated to the drawer to pay the draft.

(b) Notice of dishonor is excused if (i) by the terms of the instrument notice of dishonor is not necessary to enforce the obligation of a party to pay the instrument, or (ii) the party whose obligation is being enforced waived notice of dishonor. A waiver of presentment is also a waiver of notice of dishonor.

(c) Delay in giving notice of dishonor is excused if the delay was caused by circumstances beyond the control of the person giving the notice and the person giving the notice exercised reasonable diligence after the cause of the delay ceased to operate.

Source: L. 94: Entire article R&RE, p. 875, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-511 as it existed prior to 1994.

OFFICIAL COMMENT

Section 3-504 is largely a restatement of former Section 3-511. Subsection (4) of former Section 3-511 is replaced by Section 3-502(f).

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Presentment for payment and waiver of dishonor may be expressly or impliedly waived in accordance with this section. Torbert v. Montague, 38 Colo. 325, 87 P. 1145 (1906).

Such waiver may consist of acts and declarations of the indorser calculated to mislead the holder, put him off his guard, or induce him to forbear taking the necessary steps to charge such indorser. Torbert v. Montague, 38 Colo. 325, 87 P. 1145 (1906).

An indorser of a promissory note waives notice of dishonor under this section by repeated assurances before and after maturity that he would see that the note was paid. James v. Ward, 80 Colo. 293, 250 P. 1097 (1926).

Notice of dishonor need not be alleged in an action against the indorser where it is alleged that payment was demanded of him. De La Vergne v. Globe Printing Co., 27 Colo. App. 308, 148 P. 923 (1915).

4-3-505. Evidence of dishonor. (a) The following are admissible as evidence and create a presumption of dishonor and of any notice of dishonor stated:

(1) A document regular in form as provided in subsection (b) of this section which purports to be a protest;

(2) A purported stamp or writing of the drawee, payor bank, or presenting bank on or accompanying the instrument stating that acceptance or payment has been refused unless reasons for the refusal are stated and the reasons are not consistent with dishonor;

(3) A book or record of the drawee, payor bank, or collecting bank, kept in the usual course of business which shows dishonor, even if there is no evidence of who made the entry.

(b) A protest is a certificate of dishonor made by a United States consul or vice consul, or a notary public or other person authorized to administer oaths by the law of the place where dishonor occurs. It may be made upon information satisfactory to that person. The protest must identify the instrument and certify either that presentment has been made or, if not made, the reason why it was not made, and that the instrument has been dishonored by nonacceptance or nonpayment. The protest may also certify that notice of dishonor has been given to some or all parties.

Source: L. 94: Entire article R&RE, p. 876, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-510 as it existed prior to 1994.

OFFICIAL COMMENT

Protest is no longer mandatory and must be requested by the holder. Even if requested, protest is not a condition to the liability of indorsers or drawers. Protest is a service provided by the banking system to establish that dishonor has occurred. Like other services provided by the banking system, it will be available if market incentives, interbank agreements, or governmental regulations require it, but liabilities of parties no longer rest on it. Protest may be a requirement for liability on international drafts governed by foreign law which this Article cannot affect.

4-3-506. Recording credit card or social security numbers prohibited. (a) When payment is made by check or other negotiable instrument, a person shall not record or

require the maker of the check to record a credit card or social security number given as identification or proof of creditworthiness.

(b) Subsection (a) of this section shall not prohibit:

(1) The recording of a credit card number when a check or other negotiable instrument is issued to pay the credit card designated by the credit card number.

(2) (i) The recording of a person's social security number on a check or other negotiable instrument issued to pay a student loan.

(ii) For the purposes of this paragraph (2), "student loan" means a loan to finance higher education opportunities that is made, originated, disbursed, guaranteed, or serviced by the department of higher education, collegeinvest, an agency of another state, the federal government, or an institution of higher education, including, but not limited to, a loan that is secured pursuant to part 2 of article 3.1 of title 23, C.R.S., and a loan authorized by title IV, part B of the federal "Higher Education Act of 1965", as amended.

(3) The recording of a person's social security number on a bonafide loan application.

(c) Subsection (a) of this section shall not prohibit a person from requesting a purchaser of goods or services to display a credit card as indication of creditworthiness or identification if the only information about the credit card that is recorded is the type of credit card and the issuer of the credit card.

Source: L. 2003: Entire section added, p. 1337, § 1, effective August 6. **L. 2004:** (b)(2)(ii) amended, p. 574, § 29, effective July 1.

PART 6

DISCHARGE AND PAYMENT

4-3-601. Discharge and effect of discharge. (a) The obligation of a party to pay the instrument is discharged as stated in this article or by an act or agreement with the party which would discharge an obligation to pay money under a simple contract.

(b) Discharge of the obligation of a party is not effective against a person acquiring rights of a holder in due course of the instrument without notice of the discharge.

Source: L. 94: Entire article R&RE, p. 876, § 1, effective January 1, 1995.

Editor's note: This section is similar to former §§ 4-3-601 and 4-3-602 as they existed prior to 1994.

OFFICIAL COMMENT

Subsection (a) replaces subsections (1) and (2) of former Section 3-601. Subsection (b) restates former Section 3-602. Notice of discharge is not treated as notice of a defense that prevents holder in due course status. Section 3-302(b). Discharge is effective against a holder in due course only if the holder had notice of the discharge when holder in due course status was acquired. For example, if an instrument bearing a canceled indorsement is taken by a holder, the holder has notice that the indorser has been discharged. Thus, the discharge is effective against the holder even if the holder is a holder in due course.

ANNOTATION

Applied in Farner v. Cole, 778 P.2d 688 (Colo. 1989).

4-3-602. Payment. (a) Subject to subsection (b) of this section, an instrument is paid to the extent payment is made (i) by or on behalf of a party obliged to pay the instrument, and (ii) to a person entitled to enforce the instrument. To the extent of the payment, the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under section 4-3-306 by another person.

(b) The obligation of a party to pay the instrument is not discharged under subsection (a) of this section if:

(1) A claim to the instrument under section 4-3-306 is enforceable against the party receiving payment and (i) payment is made with knowledge by the payor that payment is prohibited by injunction or similar process of a court of competent jurisdiction, or (ii) in the case of an instrument other than a cashier's check, teller's check, or certified check, the party making payment accepted, from the person having a claim to the instrument, indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument; or

(2) The person making payment knows that the instrument is a stolen instrument and pays a person it knows is in wrongful possession of the instrument.

Source: L. 94: Entire article R&RE, p. 876, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-603 as it existed prior to 1994.

OFFICIAL COMMENT

This section replaces former Section 3-603(1). The phrase "claim to the instrument" in subsection (a) means, by reference to Section 3-306, a claim of ownership or possession and not a claim in recoupment. Subsection (b)(1)(ii) is added to conform to Section 3-411. Section 3-411 is intended to discourage an obligated bank from refusing payment of a cashier's check, certified check, or dishonored teller's check at the request of a claimant to the check who provided the bank with indemnity against loss. See Comment 1 to Section 3-411. An obligated bank that refuses payment under those circumstances not only remains liable on the check but may also be liable to the holder of the check for consequential damages. Section 3-602(b)(1)(ii) and Section 3-411, read together, change the rule of former Section 3-603(1) with respect to the obligation of the obligated bank on the check. Payment to the holder of a cashier's check, teller's check, or certified check discharges the obligation of the obligated bank on the check to both the holder and the claimant even though indemnity has been given by the person asserting the claim. If the obligated bank pays the check in violation of an agreement with the claimant in connection with the indemnity agreement, any liability that the bank may have for violation of the agreement is not governed by Article 3, but is left to other law. This section continues the rule that the obligor is not discharged on the instrument if payment is made in violation of an injunction against payment. See Section 3-411(c)(iv).

ANNOTATION

I. GENERAL CONSIDERATION.

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

II. PAYMENT OR SATISFACTION.

A negotiable instrument may be discharged by any act which will discharge a simple contract for the payment of money. Adams v. White, 173 Colo. 51, 476 P.2d 36 (1970).

Accord and satisfaction is a proper defense that can be asserted. Adams v. White, 173 Colo. 51, 476 P.2d 36 (1970).

Payment is an affirmative defense and must be specially pleaded. Florence Oil & Ref. Co. v. First Nat'l Bank, 38 Colo. 119, 88 P. 182 (1906).

Where payments are made to a payee of a note as agent for the noteholder, then, if the latter acquiesces in such a method of payment, he is thereby bound and has no recourse against the maker if he fails to receive payments as made. Burck v. Hubbard, 104 Colo. 83, 88 P.2d 955 (1939).

A bank holding a note as collateral security, but without knowledge of the maker, which permits the pledgor to represent himself as the ostensible owner and to make collections thereon, makes such pledgor its agent for collection, and payment to him operates as a bar to an action by the bank. Colo. Nat'l Bank v. Rebbein, 88 Colo. 547, 298 P. 952 (1931); Gioso v. DiBell, 88 Colo. 287, 295 P. 919 (1931);

Stockyards Nat'l Bank v. Neugebauer, 97 Colo. 246, 48 P.2d 813 (1935).

Maker of check not exposed to double liability where he was required to pay the holder since, upon payment of the checks, its liability is completely discharged. Once the obligor is discharged on the instruments, he is also discharged on the underlying obligation. Lamson v. Commercial Credit Corp., 187 Colo. 382, 531 P.2d 966 (1975).

However, payment by a borrower to a loan company of his note, which has been transferred with possession by the company before maturity, is not a payment of the note, unless an actual agency for collection on the part of the company is proven, or facts are shown which would estop the holder of the note from denying such agency. John Stuart & Co. v. Asher, 15 Colo. App. 403, 62 P. 1051 (1900).

Where notes are payable at a place and to a person specifically designated, then, if payment is made to the designated party who does not have possession of the notes, any conclusion that such party is the agent of the maker may be overcome by parol evidence showing that he is, in fact, an agent for indorsee and holder of the note to receive payment. Stark v. Stevens, 76 Colo. 550, 233 P. 619 (1925).

Although partial payment to agent bounds holder. Where a note which is payable in five years provides for an option in the maker to pay after three years and an agent is authorized to collect the note, partial payment to the agent after three, but before five years, bounds the holder. Frost v. Fisher, 13 Colo. App. 322, 58 P. 872 (1899).

III. BY PARTY SECONDARILY LIABLE.

When the guarantor of a promissory note discharges his secondary liability he is entitled to the note under the doctrine of subrogation; the essence of the doctrine of subrogation is the right of him who has paid to be put in place of one who has received payment while the primary obligation still exists. Cobbey v. Peterson, 89 Colo. 350, 3 P.2d 298 (1931).

The guarantor may sue maker. The discharge of the contract of guaranty by the guarantor does not extinguish or satisfy the obligation to which the contract of guaranty relates; consequently, it is universally held that upon payment of a note by a guarantor, when only secondarily liable, he becomes entitled to the possession of such note and may maintain an action upon it against the maker. Cone v. Eldridge, 51 Colo. 564, 119 P. 616 (1911).

Where the guarantor of a note pays the indebtedness to the holder who has transferred the paper to a third party, thus putting it out of his power to surrender the evidence of indebtedness to the guarantor, equity will afford appropriate relief to the latter even if by so doing it awards relief ordinarily cognizable only in courts of law. Cobbey v. Peterson, 89 Colo. 350, 3 P.2d 298 (1931).

Where several guarantors of promissory notes, of which a testator and another are the makers, have become assignees of, they are entitled to maintain a joint action thereon against the administrator; and what proportion they had contributed to the payment or purchase of the notes is of no concern to the administrator. Cone v. Eldridge, 51 Colo. 564, 119 P. 616 (1911).

4-3-603. Tender of payment. (a) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument, the effect of tender is governed by principles of law applicable to tender of payment under a simple contract.

(b) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument and the tender is refused, there is discharge, to the extent of the amount of the tender, of the obligation of an indorser or accommodation party having a right of recourse with respect to the obligation to which the tender relates.

(c) If tender of payment of an amount due on an instrument is made to a person entitled to enforce the instrument, the obligation of the obligor to pay interest after the due date on the amount tendered is discharged. If presentment is required with respect to an instrument and the obligor is able and ready to pay on the due date at every place of payment stated in the instrument, the obligor is deemed to have made tender of payment on the due date to the person entitled to enforce the instrument.

Source: L. 94: Entire article R&RE, p. 877, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-604 as it existed prior to 1994.

OFFICIAL COMMENT

Section 3-603 replaces former Section 3-604. Subsection (a) generally incorporates the law of tender of payment applicable to simple contracts. Subsections (b) and (c) state particular rules. Subsection (b) replaces former Section 3-604(2). Under subsection (b) refusal of a tender of payment discharges any indorser or accommodation party having a right of recourse against the party making the tender. Subsection (c) replaces former Section 3-604(1) and (3).

4-3-604. Discharge by cancellation or renunciation. (a) A person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument (i) by an intentional voluntary act, such as surrender of the instrument to the party, destruction, mutilation, or cancellation of the instrument, cancellation or striking out of the party's signature, or the addition of words to the instrument indicating discharge, or (ii) by agreeing not to sue or otherwise renouncing rights against the party by a signed writing.

(b) Cancellation or striking out of an indorsement pursuant to subsection (a) of this section does not affect the status and rights of a party derived from the indorsement.

Source: L. 94: Entire article R&RE, p. 877, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-605 as it existed prior to 1994.

OFFICIAL COMMENT

Section 3-604 replaces former Section 3-605.

ANNOTATION

Law reviews. For article, "One Year Review of Contracts", see 39 Dicta 161 (1962).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Section does not apply where note is delivered. This section, providing that the release of a promissory note must be in writing, has no application to a case where the note is delivered to the maker by an authorized agent of the holder. Kitts v. Hill, 89 Colo. 186, 300 P. 610 (1931).

This section only applies if the defense of renunciation is asserted, and does not apply when an assertion is made that a party has waived its right to receive interest under the terms of a promissory note. Ebrahimi v. E.F. Hutton & Co., Inc., 794 P.2d 1015 (Colo. App. 1989).

This section provides that the renunciation of rights in a negotiable instrument must be in writing or the instrument itself must be delivered up to the person liable thereon. Coughlin v. Truitt, 149 Colo. 26, 367 P.2d 350 (1961); Berta v. Rocchio, 149 Colo. 325, 369 P.2d 51 (1962).

So oral evidence is inadmissible to establish a renunciation or release. Tisdel v. Central Sav. Bank & Trust Co., 90 Colo. 114, 6 P.2d 912 (1931); Coughlin v. Truitt, 149 Colo. 26, 367 P.2d 350 (1961); Berta v. Rocchio, 149 Colo. 325, 369 P.2d 51 (1962). But see Edmonston v. Ascough, 43 Colo. 55, 95 P. 313 (1908).

"Renunciation" is the unilateral act of the holder usually without consideration, whereby he expresses the intention of abandoning his rights on the instrument or against one or more parties thereto. Berta v. Rocchio, 149 Colo. 325, 369 P.2d 51 (1962).

Despite the language of this section, an intent to discharge a party is required, and consideration of evidence of intent of the parties is proper in determining the issue of discharge. Columbia Sav. and Loan Ass'n v. Zelinger, 794 P.2d 231 (Colo. 1990).

Where the affirmative defense of renunciation is asserted, the burden is upon those asserting the defense to produce a written renunciation or to prove that the note has been delivered up to them. Adams v. White, 173 Colo. 51, 476 P.2d 36 (1970).

Without delivery of a note to the maker, the writing of the word "paid" across the face of the note by payee and the signing of his name thereto does not operate to discharge the liability of the maker. Wittman v. Pickens, 33 Colo. 484, 81 P. 299 (1905).

Liability is discharged by cancellation and return. The liability of the payee of a promissory note who indorses when transferring it to another is discharged by the acts of the indorsee in cancelling and returning it to the maker and

accepting in lieu thereof other evidences of indebtedness. Tomkins v. Tomkins, 78 Colo. 574, 243 P. 632 (1926).

Moreover, a note drawn to alternative, not joint, payees can be discharged only by a holder of the instrument. Reese v. Lietzan, 160 Colo. 253, 419 P.2d 959 (1966).

A cancellation induced through fraud does not act to discharge the parties to a note. Ohio Casualty Ins. Co. v. Yaklich, 768 P.2d 1274 (Colo. App. 1989).

Applied in Metro Nat'l Bank v. Roe, 675 P.2d 331 (Colo. App. 1983); Wynn v. Adams County Bank, 761 P.2d 234 (Colo. App. 1988).

4-3-605. Discharge of indorsers and accommodation parties. (a) In this section, the term "indorser" includes a drawer having the obligation described in section 4-3-414 (d).

(b) Discharge, under section 4-3-604, of the obligation of a party to pay an instrument does not discharge the obligation of an indorser or accommodation party having a right of recourse against the discharged party.

(c) If a person entitled to enforce an instrument agrees, with or without consideration, to an extension of the due date of the obligation of a party to pay the instrument, the extension discharges an indorser or accommodation party having a right of recourse against the party whose obligation is extended to the extent the indorser or accommodation party proves that the extension caused loss to the indorser or accommodation party with respect to the right of recourse.

(d) If a person entitled to enforce an instrument agrees, with or without consideration, to a material modification of the obligation of a party other than an extension of the due date, the modification discharges the obligation of an indorser or accommodation party having a right of recourse against the person whose obligation is modified to the extent the modification causes loss to the indorser or accommodation party with respect to the right of recourse. The loss suffered by the indorser or accommodation party as a result of the modification is equal to the amount of the right of recourse unless the person enforcing the instrument proves that no loss was caused by the modification or that the loss caused by the modification was an amount less than the amount of the right of recourse.

(e) If the obligation of a party to pay an instrument is secured by an interest in collateral and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of an indorser or accommodation party having a right of recourse against the obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent (i) the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge, or (ii) the reduction in value of the interest causes an increase in the amount by which the amount of the right of recourse exceeds the value of the interest. The burden of proving impairment is on the party asserting discharge.

(f) If the obligation of a party is secured by an interest in collateral not provided by an accommodation party and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of any party who is jointly and severally liable with respect to the secured obligation is discharged to the extent the impairment causes the party asserting discharge to pay more than that party would have been obliged to pay, taking into account rights of contribution, if impairment had not occurred. If the party asserting discharge is an accommodation party not entitled to discharge under subsection (e) of this section, the party is deemed to have a right to contribution based on joint and several liability rather than a right to reimbursement. The burden of proving impairment is on the party asserting discharge.

(g) Under subsection (e) or (f) of this section, impairing value of an interest in collateral includes (i) failure to obtain or maintain perfection or recordation of the interest in collateral, (ii) release of collateral without substitution of collateral of equal value, (iii) failure to perform a duty to preserve the value of collateral owed, under article 9 or other law, to a debtor or surety or other person secondarily liable, or (iv) failure to comply with applicable law in disposing of collateral.

(h) An accommodation party is not discharged under subsection (c), (d), or (e) of this section unless the person entitled to enforce the instrument knows of the accommodation or has notice under section 4-3-419 (c) that the instrument was signed for accommodation.

(i) A party is not discharged under this section if (i) the party asserting discharge consents to the event or conduct that is the basis of the discharge, or (ii) the instrument or a separate agreement of the party provides for waiver of discharge under this section either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral.

Source: L. 94: Entire article R&RE, p. 878, § 1, effective January 1, 1995.

Editor's note: This section is similar to former § 4-3-606 as it existed prior to 1994.

OFFICIAL COMMENT

1. Section 3-605, which replaces former Section 3-606, can be illustrated by an example. Bank lends $10,000 to Borrower who signs a note under which Borrower is obliged to pay $10,000 to Bank on a due date stated in the note. Bank insists, however, that Accommodation Party also become liable to pay the note. Accommodation Party can incur this liability by signing the note as a co-maker or by indorsing the note. In either case the note is signed for accommodation and Borrower is the accommodated party. Rights and obligations of Accommodation Party in this case are stated in Section 3-419. Suppose that after the note is signed, Bank agrees to a modification of the rights and obligations between Bank and Borrower. For example, Bank agrees that Borrower may pay the note at some date after the due date, or that Borrower may discharge Borrower's $10,000 obligation to pay the note by paying Bank $3,000, or that Bank releases collateral given by Borrower to secure the note. Under the law of suretyship Borrower is usually referred to as the principal debtor and Accommodation Party is referred to as the surety. Under that law, the surety can be discharged under certain circumstances if changes of this kind are made by Bank, the creditor, without the consent of Accommodation Party, the surety. Rights of the surety to discharge in such cases are commonly referred to as suretyship defenses. Section 3-605 is concerned with this kind of problem in the context of a negotiable instrument to which the principal debtor and the surety are parties. But Section 3-605 has a wider scope. It also applies to indorsers who are not accommodation parties. Unless an indorser signs without recourse, the indorser's liability under Section 3-415 (a) is that of a guarantor of payment. If Bank in our hypothetical case indorsed the note and transferred it to Second Bank, Bank has rights given to an indorser under Section 3-605 if it is Second Bank that modifies rights and obligations of Borrower. Both accommodation parties and indorsers will be referred to in these Comments as sureties. The scope of Section 3-605 is also widened by subsection (e) which deals with rights of a non-accommodation party co-maker when collateral is impaired.

2. The importance of suretyship defenses is greatly diminished by the fact that they can be waived. The waiver is usually made by a provision in the note or other writing that represents the obligation of the principal debtor. It is standard practice to include a waiver of suretyship defenses in notes given to financial institutions or other commercial creditors. Section 3-605(i) allows waiver. Thus, Section 3-605 applies to the occasional case in which the creditor did not include a waiver clause in the instrument or in which the creditor did not obtain the permission of the surety to take the action that triggers the suretyship defense.

3. Subsection (b) addresses the effect of discharge under Section 3-604 of the principal debtor. In the hypothetical case stated in Comment 1, release of Borrower by Bank does not release Accommodation Party. As a practical matter, Bank will not gratuitously release Borrower. Discharge of Borrower normally would be part of a settlement with Borrower if Borrower is insolvent or in financial difficulty. If Borrower is unable to pay all creditors, it may be prudent for Bank to take partial payment, but Borrower will normally insist on a release of the obligation. If Bank takes $3,000 and releases Borrower from the $10,000 debt, Accommodation Party is not injured. To the extent of the payment Accommodation Party's obligation to Bank is reduced. The release of Borrower by Bank does not affect the right of Accommodation Party to obtain reimbursement from Borrower if Accommodation Party pays Bank. Section 3-419(e). Subsection (b) is designed to allow a creditor to settle with the principal debtor without risk of losing rights against sureties. Settlement is in the interest of sureties as well as the creditor. Subsection (b) changes the law stated in former Section 3-606 but the change relates largely to formalities rather than substance. Under former Section 3-606, Bank could settle with and release Borrower without releasing Accommodation Party, but to accomplish that result Bank had to either obtain the consent of Accommodation Party or make an express reservation of rights against Accommodation Party at the time it released Borrower. The reservation of rights was made in the agree-

ment between Bank and Borrower by which the release of Borrower was made. There was no requirement in former Section 3-606 that any notice be given to Accommodation Party. The reservation of rights doctrine is abolished in Section 3-605 with respect to rights on instruments.

4. Subsection (c) relates to extensions of the due date of the instrument. In most cases an extension of time to pay a note is a benefit to both the principal debtor and sureties having recourse against the principal debtor. In relatively few cases the extension may cause loss if deterioration of the financial condition of the principal debtor reduces the amount that the surety will be able to recover on its right of recourse when default occurs. Former Section 3-606(1)(a) did not take into account the presence or absence of loss to the surety. For example, suppose the instrument is an installment note and the principal debtor is temporarily short of funds to pay a monthly installment. The payee agrees to extend the due date of the installment for a month or two to allow the debtor to pay when funds are available. Under former Section 3-606 surety was discharged if consent was not given unless the payee expressly reserved rights against the surety. It did not matter that the extension of time was a trivial change in the guaranteed obligation and that there was no evidence that the surety suffered any loss because of the extension. **Wilmington Trust Co. v. Gesullo,** 29 U.C.C. Rep. 144 (Del. Super. Ct. 1980). Under subsection (c) an extension of time results in discharge only to the extent the surety proves that the extension caused loss. For example, if the extension is for a long period the surety might be able to prove that during the period of extension the principal debtor became insolvent, thus reducing the value of the right of recourse of the surety. By putting the burden on the surety to prove loss, subsection (c) more accurately reflects what the parties would have done by agreement, and it facilitates workouts.

5. Former Section 3-606 applied to extensions of the due date of a note but not to other modifications of the obligation of the principal debtor. There was no apparent reason why former Section 3-606 did not follow general suretyship law in covering both. Under Section 3-605(d) a material modification of the obligation of the principal debtor, other than an extension of the due date, will result in discharge of the surety to the extent the modification caused loss to the surety with respect to the right of recourse. The loss caused by the modification is deemed to be the entire amount of the right of recourse unless the person seeking enforcement of the instrument proves that no loss occurred or that the loss was less than the full amount of the right of recourse. In the absence of that proof, the surety is completely discharged. The rationale for having different rules with respect to loss for extensions of the due date and other modifications is that extensions are likely to be beneficial to the surety and they are often made. Other modifications are less common and they may very well be detrimental to the surety. Modification of the obligation of the principal debtor without permission of the surety is unreasonable unless the modification is benign. Subsection (d) puts the burden on the person seeking enforcement of the instrument to prove the extent to which loss was not caused by the modification.

6. Subsection (e) deals with discharge of sureties by impairment of collateral. It generally conforms to former Section 3-606(1)(b). Subsection (g) states common examples of what is meant by impairment. By using the term "includes," it allows a court to find impairment in other cases as well. There is extensive case law on impairment of collateral. The surety is discharged to the extent the surety proves that impairment was caused by a person entitled to enforce the instrument. For example, suppose the payee of a secured note fails to perfect the security interest. The collateral is owned by the principal debtor who subsequently files in bankruptcy. As a result of the failure to perfect, the security interest is not enforceable in bankruptcy. If the payee obtains payment from the surety, the surety is subrogated to the payee's security interest in the collateral. In this case the value of the security interest is impaired completely because the security interest is unenforceable. If the value of the collateral is as much or more than the amount of the note there is a complete discharge.

In some states a real property grantee who assumes the obligation of the grantor as maker of a note secured by the real property becomes by operation of law a principal debtor and the grantor becomes a surety. The meager case authority was split on whether former Section 3-606 applied to release the grantor if the holder released or extended the obligation of the grantee. Revised Article 3 takes no position on the effect of the release of the grantee in this case. Section 3-605(e) does not apply because the holder has not discharged the obligation of a "party," a term defined in Section 3-103(a)(8) as "party to an instrument." The assuming grantee is not a party to the instrument.

7. Subsection (f) is illustrated by the following case. X and Y sign a note for $1,000 as co-makers. Neither is an accommodation party. X grants a security interest in X's property to secure the note. The collateral is worth more than $1,000. Payee fails to perfect the security interest in X's property before X files in bankruptcy. As a result the security interest is not enforceable in bankruptcy. Had Payee perfected the security interest, Y could have paid the note and gained rights to X's collateral by subroga-

tion. If the security interest had been perfected, Y could have realized on the collateral to the extent of $500 to satisfy its right of contribution against X. Payee's failure to perfect deprived Y of the benefit of the collateral. Subsection (f) discharges Y to the extent of its loss. If there are no assets in the bankruptcy for unsecured claims, the loss is $500, the amount of Y's contribution claim against X which now has a zero value. If some amount is payable on unsecured claims, the loss is reduced by the amount receivable by Y. The same result follows if Y is an accommodation party but Payee has no knowledge of the accommodation or notice under Section 3-419(c). In that event Y is not discharged under subsection (e), but subsection (f) applies because X and Y are jointly and severally liable on the note. Under subsection (f), Y is treated as a co-maker with a right of contribution rather than an accommodation party with a right of reimbursement. Y is discharged to the extent of $500. If Y is the principal debtor and X is the accommodation party subsection (f) doesn't apply. Y, as principal debtor, is not injured by the impairment of collateral because Y would have been obliged to reimburse X for the entire $1,000 even if Payee had obtained payment from sale of the collateral.

8. Subsection (i) is a continuation of former law which allowed suretyship defenses to be waived.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

A verbal promise, without consideration, to release a joint maker and look to the principal maker alone does not release him from liability. Edmonston v. Ascough, 43 Colo. 55, 95 P. 313 (1908).

Nor does a request by such an accommodation maker that the holder of the note sue the principal maker discharge him from liability where the holder refuses and the principal maker becomes insolvent. Edmonston v. Ascough, 43 Colo. 55, 95 P. 313 (1908).

Also, an extension of time of payment of a promissory note must be by agreement of the parties and based upon a valid consideration. Am. Medical & Dental Ass'n v. Grant, 87 Colo. 183, 285 P. 1099 (1930).

A holder cannot arbitrarily extend time for payment. Stipulation in a promissory note that makers and indorsers agree to any extension of time of payment before, at, or after maturity does not mean that the holder can arbitrarily extend the time of payment. Am. Medical & Dental Ass'n v. Grant, 87 Colo. 183, 285 P. 1099 (1930).

As between the maker and payee of a note, an agreement to extend the time of payment until a copy of patent to land can be obtained is not invalid as an indefinite extension. Drake v. Pueblo Nat'l Bank, 44 Colo. 49, 96 P. 999 (1908).

Though such does not apply to a surety. A surety is primarily liable, and one primarily liable thereunder is not released from liability by an extension of the time of payment to the principal maker without the surety's consent. Only the person who can be released by a binding agreement extending time is one "secondarily" liable and as a surety is not "secondarily", but "primarily", liable, he is not released by such extension. Hall v. Farmers' Bank, 74 Colo. 165, 220 P. 237 (1923).

Where the holder of a note obtains control of property which a surety on the note is entitled to have applied to the payment of the note, thereby preventing the surety from being subrogated to the holder's rights in such property, the surety is released from liability. Crosby v. Woodbury, 37 Colo. 1, 89 P. 34 (1906).

Instructions merely stating section must include interpretation. Where instruction on impairment of recourse or of collateral is correct statement of law relative to defendant's defense, it is error not to include interpretation of this highly technical statute in instructions to aid jury in applying statute to facts of case. Pueblo Bank & Trust Co. v. McMartin, 31 Colo. App. 546, 506 P.2d 759 (1972).

Subsection (2) (under former law) does not require notification and consent as a prerequisite to an express reservation of rights. Although plaintiff discharged defendants in assumption agreement, it expressly reserved its rights against them. Therefore the defendants remained liable on their obligation to plaintiff. Matthews v. Saleen, 812 P.2d 1186 (Colo. App. 1991).

Failure to object to an increase in risk, the terms of which were never explained, cannot be deemed a consent to impairment of collateral. Haberl v. Bigelow, 855 P.2d 1368 (Colo. 1993).

Under former § 4-3-606, a prior, express consent provision in an instrument waives either a surety or a co-maker's right to claim a discharge of obligations based upon later modifications to the obligation. Crown Life Ins. Co. v. Haag Ltd. P'ship, 929 P.2d 42 (Colo. App. 1996).

Applied in Moss v. McDonald, 772 P.2d 626 (Colo. App. 1988); Resolution Trust Corp. v. Teem P'ship, 835 F. Supp. 563 (D. Colo. 1993).

ARTICLE 4

Bank Deposits and Collections

Editor's note: This article was numbered as article 4 of chapter 155, C.R.S. 1963. This article was amended with relocations in 1994, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 1994, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated.

PART 1

GENERAL PROVISIONS AND DEFINITIONS

PART 2

COLLECTION OF ITEMS - DEPOSITARY AND COLLECTING BANKS

PART 3

COLLECTION OF ITEMS - PAYOR BANKS

PART 4

RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER

PART 1

GENERAL PROVISIONS AND DEFINITIONS

4-4-101. Short title. This article may be cited as the "Uniform Commercial Code - Bank Deposits and Collections".

Source: L. 94: Entire article amended with relocations, p. 879, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. The great number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections. There is needed a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years. This Article meets that need.

2. In 1950 at the time Article 4 was drafted, 6.7 billion checks were written annually. By the time of the 1990 revision of Article 4 annual volume was estimated by the American Bankers Association to be about 50 billion checks. The banking system could not have coped with this increase in check volume had it not developed in the late 1950s and early 1960s an automated system for check collection based on encoding checks with machine-readable information by Magnetic Ink Character Recognition (MICR). An important goal of the 1990 revision of Article 4 is to promote the efficiency of the check collection process by making the provisions of Article 4 more compatible with the needs of an automated system and, by doing so, increase the speed and lower the cost of check collection for those who write and receive checks. An additional goal of the 1990 revision of Article 4 is to remove any statutory barriers in the Article to the ultimate adoption of programs allowing the presentment of checks to payor banks by electronic transmission of information captured from the MICR line on the checks. The potential of these programs for saving the time and expense of transporting the huge volume of checks from depositary to payor banks is evident.

3. Article 4 defines rights between parties with respect to bank deposits and collections. It is not a regulatory statute. It does not regulate the terms of the bank-customer agreement, nor does it prescribe what constraints different jurisdictions may wish to impose on that relationship in the interest of consumer protection. The revisions in Article 4 are intended to create a legal framework that accommodates automation and truncation for the benefit of all bank customers. This may raise consumer problems which enacting jurisdictions may wish to address in individual legislation. For example, with respect to Section 4-401(c), jurisdictions may wish to examine their unfair and deceptive practices laws to determine whether they are adequate to protect drawers who postdate checks from unscrupulous practices that may arise on the part of persons who induce drawers to issue postdated checks in the erroneous belief that the checks will not be immediately payable. Another example arises from the fact that under various truncation plans customers will no longer receive their cancelled checks and will no longer have the cancelled check to prove payment. Individual legislation might provide that a copy of a bank statement along with a copy of the check is prima facie evidence of payment.

ANNOTATION

Law reviews. For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965). For article, "Article 4 — Bank Deposits and Collections", see 38 U. Colo. L. Rev. 65 (1965).

For cases construing provisions prior to U.C.C. concerning bank collections, see Peterson v. First State Bank, 79 Colo. 494, 246 P. 784 (1926); McAloon v. Ericson, 84 Colo. 467, 271 P. 192 (1928); McFerson v. Western Colo. Power Co., 102 Colo. 261, 78 P.2d 625 (1938); Walter E. Heller & Co. v. Mesa Bldg. Prods. Co., 233 F. Supp. 434 (D. Colo. 1964); Barnes v. Cherry Creek Nat'l Bank, 163 Colo. 414, 431 P.2d 471 (1967) (decided under repealed § 14-8-1 et seq., C.R.S. 1963, § 14-8-1 et seq., CRS 53, CSA C. 18, §§ 46 through 62, and laws antecedent to CSA, C. 18, §§ 46 through 62).

4-4-102. Applicability. (a) To the extent that items within this article are also within articles 3 and 8 of this title, they are subject to those articles. If there is conflict, this article governs said article 3, but article 8 governs this article.

(b) The liability of a bank for action or nonaction with respect to any item handled by it for purposes of presentment, payment, or collection is governed by the law of the place where the bank is located. In the case of action or nonaction by or at a branch or separate office of a bank, its liability is governed by the law of the place where the branch or separate office is located.

Source: L. 94: Entire article amended with relocations, p. 879, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. The rules of Article 3 governing negotiable instruments, their transfer, and the contracts of the parties thereto apply to the items collected through banking channels wherever no specific provision is found in this Article. In the case of conflict, this Article governs. See Section 3-102(b).

Bonds and like instruments constituting investment securities under Article 8 may also be handled by banks for collection purposes. Various sections of Article 8 prescribe rules of transfer some of which (see Sections 8-304 and 8-306) may conflict with provisions of this Article (Sections 4-205, 4-207, and 4-208). In the case of conflict, Article 8 governs.

Section 4-210 deals specifically with overlapping problems and possible conflicts between this Article and Article 9. However, similar reconciling provisions are not necessary in the case of Articles 5 and 7. Sections 4-301 and 4-302 are consistent with Section 5-112. In the case of Article 7 documents of title frequently accompany items but they are not themselves items. See Section 4-104(a)(9).

In **Clearfield Trust Co. v. United States**, 318 U.S. 363 (1943), the Court held that if the United States is a party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In **United States v. Kimbell Foods, Inc.**, 440 U.S. 715 (1979), the Court stated a three-pronged test to ascertain whether the federal common-law rule should follow the state rule. In most instances courts under the **Kimbell** test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In **Kimbell** the Court adopted the priorities rules of Article 9.

In addition, applicable federal law may supersede provisions of this Article. One federal law that does so is the Expedited Funds Availability Act, 12 U.S.C. § 4001 et seq., and its implementing Regulation CC, 12 CFR Pt. 229. In some instances this law is alluded to in the statute, e.g., Section 4-215(e) and (f). In other instances, although not referred to in this Article, the provisions of the EFAA and Regulation CC control with respect to checks. For example, except between the depositary bank and its customer, all settlements are final and not provisional (Regulation CC, Section 229.36(d)), and the midnight deadline may be extended (Regulation CC, Section 229.30(c)). The Comments to this Article suggest in most instances the relevant Regulation CC provisions.

2. Subsection (b) is designed to state a workable rule for the solution of otherwise vexatious problems of the conflicts of laws:

a. The routine and mechanical nature of bank collections makes it imperative that one law govern the activities of one office of a bank. The requirement found in some cases that to hold an indorser notice must be given in accordance with the law of the place of indorsement, since that method of notice became an implied term of the indorser's contract, is more theoretical than practical.

b. Adoption of what is in essence a tort theory of the conflict of laws is consistent with the general theory of this Article that the basic duty

of a collecting bank is one of good faith and the exercise of ordinary care. Justification lies in the fact that, in using an ambulatory instrument, the drawer, payee, and indorsers must know that action will be taken with respect to it in other jurisdictions. This is especially pertinent with respect to the law of the place of payment.

c. The phrase "action or non-action with respect to any item handled by it for purposes of presentment, payment, or collection" is intended to make the conflicts rule of subsection (b) apply from the inception of the collection process of an item through all phases of deposit, forwarding, presentment, payment and remittance or credit of proceeds. Specifically the subsection applies to the initial act of a depositary bank in receiving an item and to the incidents of such receipt. The conflicts rule of **Weissman v. Banque de Bruxelles**, 254 N.Y. 488, 173 N.E. 835 (1930), is rejected. The subsection applies to questions of possible vicarious liability of a bank for action or non-action of sub-agents (see Section 4-202(c)), and tests these questions by the law of the state of the location of the bank which uses the sub-agent. The conflicts rule of **St. Nicholas Bank of New York v. State Nat. Bank**, 128 N.Y. 26, 27 N.E. 849, 13 L.R.A. 241 (1891), is rejected. The subsection applies to action or non-action of a payor bank in connection with handling an item (see Sections 4-215(a), 4-301, 4-302, 4-303) as well as action or non-action of a collecting bank (Sections 4-201 through 4-216); to action or non-action of a bank which suspends payment or is affected by another bank suspending payment (Section 4-216); to action or non-action of a bank with respect to an item under the rule of Part 4 of Article 4.

d. In a case in which subsection (b) makes this Article applicable, Section 4-103(a) leaves open the possibility of an agreement with respect to applicable law. This freedom of agreement follows the general policy of Section 1-105.

4-4-103. Variation by agreement - measure of damages - action constituting ordinary care. (a) The effect of the provisions of this article may be varied by agreement, but the parties to the agreement cannot disclaim a bank's responsibility for its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or failure. However, the parties may determine by agreement the standards by which the bank's responsibility is to be measured if those standards are not manifestly unreasonable.

(b) Federal reserve regulations and operating circulars, clearing-house rules, and the like have the effect of agreements under subsection (a) of this section, whether or not specifically assented to by all parties interested in items handled.

(c) Action or nonaction approved by this article or pursuant to federal reserve regulations or operating circulars is the exercise of ordinary care and, in the absence of special instructions, action or nonaction consistent with clearing-house rules and the like or with a general banking usage not disapproved by this article, is prima facie the exercise of ordinary care.

(d) The specification or approval of certain procedures by this article is not disapproval of other procedures that may be reasonable under the circumstances.

(e) The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care. If there is also bad faith it includes any other damages the party suffered as a proximate consequence.

Source: L. 94: Entire article amended with relocations, p. 880, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. Section 1-102 states the general principles and rules for variation of the effect of this Act by agreement and the limitations to this power. Section 4-103 states the specific rules for variation of Article 4 by agreement and also certain standards of ordinary care. In view of the technical complexity of the field of bank collections, the enormous number of items handled by banks, the certainty that there will be variations from the normal in each day's work in each bank, the certainty of changing conditions and the possibility of developing improved methods of collection to speed the process, it would be unwise to freeze present methods of operation by mandatory statutory rules. This section, therefore, permits within wide limits variation of the effect of provisions of the Article by agreement.

2. Subsection (a) confers blanket power to vary all provisions of the Article by agreements

of the ordinary kind. The agreements may not disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care and may not limit the measure of damages for the lack or failure, but this subsection like Section 1-102(3) approves the practice of parties determining by agreement the standards by which the responsibility is to be measured. In the absence of a showing that the standards manifestly are unreasonable, the agreement controls. Owners of items and other interested parties are not affected by agreements under this subsection unless they are parties to the agreement or are bound by adoption, ratification, estoppel or the like.

As here used "agreement" has the meaning given to it by Section 1-201(3). The agreement may be direct, as between the owner and the depositary bank; or indirect, as in the case in which the owner authorizes a particular type of procedure and any bank in the collection chain acts pursuant to such authorization. It may be with respect to a single item; or to all items handled for a particular customer, e.g., a general agreement between the depositary bank and the customer at the time a deposit account is opened. Legends on deposit tickets, collection letters and acknowledgments of items, coupled with action by the affected party constituting acceptance, adoption, ratification, estoppel or the like, are agreements if they meet the tests of the definition of "agreement." See Section 1-201(3). **First Nat. Bank of Denver v. Federal Reserve Bank,** 6 F.2d 339 (8th Cir. 1925) (deposit slip); **Jefferson County Bldg. Ass'n v. Southern Bank & Trust Co.,** 225 Ala. 25, 142 So. 66 (1932) (signature card and deposit slip); **Semingson v. Stock Yards Nat. Bank,** 162 Minn. 424, 203 N.W. 412 (1925) (passbook); **Farmers State Bank v. Union Nat. Bank,** 42 N.D. 449, 454, 173 N.W. 789, 790 (1919) (acknowledgment of receipt of item).

3. Subsection (a) (subject to its limitations with respect to good faith and ordinary care) goes far to meet the requirements of flexibility. However, it does not by itself confer fully effective flexibility. Since it is recognized that banks handle a great number of items every business day and that the parties interested in each item include the owner of the item, the drawer (if it is a check), all nonbank indorsers, the payor bank and from one to five or more collecting banks, it is obvious that it is impossible, practically, to obtain direct agreements from all of these parties on all items. In total, the interested parties constitute virtually every adult person and business organization in the United States. On the other hand they may become bound to agreements on the principle that collecting banks acting as agents have authority to make binding agreements with respect to items being handled. This conclusion was assumed but was not flatly decided in **Federal Reserve Bank of Richmond v. Malloy,** 264 U.S. 160, at 167, 44 S.Ct. 296, at 298, 68 L.Ed. 617, 31 A.L.R. 1261 (1924).

To meet this problem subsection (b) provides that official or quasi-official rules of collection, that is Federal Reserve regulations and operating circulars, clearing-house rules, and the like, have the effect of agreements under subsection (a), whether or not specifically assented to by all parties interested in items handled. Consequently, such official or quasi-official rules may, standing by themselves but subject to the good faith and ordinary care limitations, vary the effect of the provisions of Article 4.

Federal Reserve regulations. Various sections of the Federal Reserve Act (12 U.S.C. § 221 et seq.) authorize the Board of Governors of the Federal Reserve System to direct the Federal Reserve banks to exercise bank collection functions. For example, Section 16 (12 U.S.C. § 248(o)) authorizes the Board to require each Federal Reserve bank to exercise the functions of a clearing house for its members and Section 13 (12 U.S.C. § 342) authorizes each Federal Reserve bank to receive deposits from nonmember banks solely for the purposes of exchange or of collection. Under this statutory authorization the Board has issued Regulation J (Subpart A — Collection of Checks and Other Items). Under the supremacy clause of the Constitution, federal regulations prevail over state statutes. Moreover, the Expedited Funds Availability Act, 12 U.S.C. Section 4007(b) provides that the Act and Regulation CC, 12 CFR 229, supersede "any provision of the law of any State, including the Uniform Commercial Code as in effect in such State, which is inconsistent with this chapter or such regulations." See Comment 1 to Section 4-102.

Federal Reserve operating circulars. The regulations of the Federal Reserve Board authorize the Federal Reserve banks to promulgate operating circulars covering operating details. Regulation J, for example, provides that "Each Reserve Bank shall receive and handle items in accordance with this subpart, and shall issue operating circulars governing the details of its handling of items and other matters deemed appropriate by the Reserve Bank." This Article recognizes that "operating circulars" issued pursuant to the regulations and concerned with operating details as appropriate may, within their proper sphere, vary the effect of the Article.

Clearing-House Rules. Local clearing houses have long issued rules governing the details of clearing; hours of clearing, media of remittance, time for return of mis-sent items and the like. The case law has recognized these rules, within their proper sphere, as binding on affected parties and as appropriate sources for the courts to look to in filling out details of bank collection law. Subsection (b) in recognizing clearing-house rules as a means of preserving

flexibility continues the sensible approach indicated in the cases. Included in the term "clearing houses" are county and regional clearing houses as well as those within a single city or town. There is, of course, no intention of authorizing a local clearing house or a group of clearing houses to rewrite the basic law generally. The term "clearing-house rules" should be understood in the light of functions the clearing houses have exercised in the past.

And the like. This phrase is to be construed in the light of the foregoing. "Federal Reserve regulations and operating circulars" cover rules and regulations issued by public or quasi-public agencies under statutory authority. "Clearing-house rules" cover rules issued by a group of banks which have associated themselves to perform through a clearing house some of their collection, payment and clearing functions. Other agencies or associations of this kind may be established in the future whose rules and regulations could be appropriately looked on as constituting means of avoiding absolute statutory rigidity. The phrase "and the like" leaves open possibilities for future development. An agreement between a number of banks or even all the banks in an area simply because they are banks, would not of itself, by virtue of the phrase "and the like," meet the purposes and objectives of subsection (b).

4. Under this Article banks come under the general obligations of the use of good faith and the exercise of ordinary care. "Good faith" is defined in Section 3-103(a)(4). The term "ordinary care" is defined in Section 3-103(a)(7). These definitions are made to apply to Article 4 by Section 4-104(c). Section 4-202 states respects in which collecting banks must use ordinary care. Subsection (c) of Section 4-103 provides that action or non-action approved by the Article or pursuant to Federal Reserve regulations or operating circulars constitutes the exercise of ordinary care. Federal Reserve regulations and operating circulars constitute an affirmative standard of ordinary care equally with the provisions of Article 4 itself.

Subsection (c) further provides that, absent special instructions, action or non-action consistent with clearing-house rules and the like or with a general banking usage not disapproved by the Article, prima facie constitutes the exercise of ordinary care. Clearing-house rules and the phrase "and the like" have the significance set forth above in these Comments. The term "general banking usage" is not defined but should be taken to mean a general usage common to banks in the area concerned. See Section 1-205(2). In a case in which the adjective "general" is used, the intention is to require a usage broader than a mere practice between two or three banks but it is not intended to require anything as broad as a country-wide usage. A usage followed generally throughout a state, a substantial portion of a state, a metropolitan area or the like would certainly be sufficient. Consistently with the principle of Section 1-205(3), action or non-action consistent with clearing-house rules or the like or with banking usages prima facie constitutes the exercise of ordinary care. However, the phrase "in the absence of special instructions" affords owners of items an opportunity to prescribe other standards and although there may be no direct supervision or control of clearing houses or banking usages by official supervisory authorities, the confirmation of ordinary care by compliance with these standards is prima facie only, thus conferring on the courts the ultimate power to determine ordinary care in any case in which it should appear desirable to do so. The prima facie rule does, however, impose on the party contesting the standards to establish that they are unreasonable, arbitrary or unfair as used by the particular bank.

5. Subsection (d), in line with the flexible approach required for the bank collection process is designed to make clear that a novel procedure adopted by a bank is not to be considered unreasonable merely because that procedure is not specifically contemplated by this Article or by agreement, or because it has not yet been generally accepted as a bank usage. Changing conditions constantly call for new procedures and someone has to use the new procedure first. If this procedure is found to be reasonable under the circumstances, provided, of course, that it is not inconsistent with any provision of the Article or other law or agreement, the bank which has followed the new procedure should not be found to have failed in the exercise of ordinary care.

6. Subsection (e) sets forth a rule for determining the measure of damages for failure to exercise ordinary care which, under subsection (a), cannot be limited by agreement. In the absence of bad faith the maximum recovery is the amount of the item concerned. The term "bad faith" is not defined; the connotation is the absence of good faith (Section 3-103). When it is established that some part or all of the item could not have been collected even by the use of ordinary care the recovery is reduced by the amount that would have been in any event uncollectible. This limitation on recovery follows the case law. Finally, if bad faith is established the rule opens to allow the recovery of other damages, whose "proximateness" is to be tested by the ordinary rules applied in comparable cases. Of course, it continues to be as necessary under subsection (e) as it has been under ordinary common law principles that, before the damage rule of the subsection becomes operative, liability of the bank and some loss to the customer or owner must be established.

ANNOTATION

Breach of duties of "good faith" and "ordinary care". In transferring checks to a third party, a bank breaches its duty of "good faith" only if it deals dishonestly in transferring checks, and breaches its duty of "ordinary care" only if a reasonable holder in the bank's position, in the exercise of ordinary care, would not have transferred the checks. Commercial Credit Corp. v. Univ. Nat'l Bank, 590 F.2d 849 (10th Cir. 1979).

Customer's failure to prove loss. A partnership that could not meet its burden of proving that a bank's improper payment of drafts drawn on the partnership's account caused the partnership to suffer a loss could not have its account recredited for the amount of the draft payments. Isaac v. Am. Heritage Bank & Trust Co., 675 P.2d 742 (Colo. 1984).

Bad faith. Bad faith means actions in knowing or reckless disregard of customer's contractual rights and negligence alone does not constitute bad faith. Peregrine Homes v. Jefferson Bank & Trust, 713 P.2d 1342 (Colo. App. 1985).

Applied in Wheat State Serv. Corp. v. Colfax Nat'l Bank, 44 Colo. App. 376, 618 P.2d 696 (1980); Am. Heritage Bank & Trust Co. v. Isaac, 636 P.2d 1296 (Colo. App. 1981).

4-4-104. Definitions and index of definitions. (a) In this article, unless the context otherwise requires:

(1) "Account" means any deposit or credit account with a bank, including a demand, time, savings, passbook, share draft, or like account, other than an account evidenced by a certificate of deposit;

(2) "Afternoon" means the period of a day between noon and midnight;

(3) "Banking day" means the part of a day, excluding Saturday, Sunday, and holidays, on which a bank is open to the public for carrying on substantially all of its banking functions;

(4) "Clearing-house" means an association of banks or other payors regularly clearing items;

(5) "Customer" means a person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another bank;

(6) "Documentary draft" means a draft to be presented for acceptance or payment if specified documents, certificated securities (section 4-8-102) or instruction for uncertificated securities (section 4-8-102), or other certificates, statements, or the like are to be received by the drawee or other payor before acceptance or payment of the draft;

(7) "Draft" means a draft as defined in section 4-3-104 or an item, other than an instrument, that is an order;

(8) "Drawee" means a person ordered in a draft to make payment;

(9) "Item" means an instrument or a promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by article 4.5 of this title or a credit or debit card slip;

(10) "Midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later;

(11) "Settle" means to pay in cash, by clearing-house settlement, in a charge or credit, or by remittance, or otherwise as agreed. A settlement may be either provisional or final;

(12) "Suspends payments" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over or that it ceases or refuses to make payments in the ordinary course of business.

(b) Other definitions applying to this article and the sections in which they appear are:

"Agreement for electronic presentment"	Section 4-4-110
"Bank"	Section 4-4-105
"Collecting bank"	Section 4-4-105
"Depositary bank"	Section 4-4-105
"Intermediary bank"	Section 4-4-105
"Payor bank"	Section 4-4-105
"Presenting bank"	Section 4-4-105
"Presentment notice"	Section 4-4-110

(c) "Control" as provided in section 4-7-106 and the following definitions in other articles of this title apply to this article:

"Acceptance"	Section 4-3-409
"Alteration"	Section 4-3-407
"Cashier's check"	Section 4-3-104
"Certificate of deposit"	Section 4-3-104
"Certified check"	Section 4-3-409
"Check"	Section 4-3-104
"Good faith"	Section 4-3-103
"Holder in due course"	Section 4-3-302
"Instrument"	Section 4-3-104
"Notice of dishonor"	Section 4-3-503
"Order"	Section 4-3-103
"Ordinary care"	Section 4-3-103
"Person entitled to enforce"	Section 4-3-301
"Presentment"	Section 4-3-501
"Promise"	Section 4-3-103
"Prove"	Section 4-3-103
"Teller's check"	Section 4-3-104
"Unauthorized signature"	Section 4-3-403

(d) In addition, article 1 of this title contains general definitions and principles of construction and interpretation applicable throughout this article.

Source: L. 94: Entire article amended with relocations, p. 880, § 2, effective January 1, 1995. **L. 96:** (a)(6) amended, p. 234, § 6, effective July 1. **L. 2006:** (c) amended, p. 496, § 26, effective September 1. **L. 2007:** (c) amended, p. 375, § 28, effective August 3.

Editor's note - Colorado legislative change. In subsection (a)(3), Colorado added the words "excluding Saturday, Sunday, and holidays".

Cross references: For the conduct of banking business on Saturday, see § 11-105-103; for legal holidays, see § 24-11-101.

OFFICIAL COMMENT

1. Paragraph (a)(1): "Account" is defined to include both asset accounts in which a customer has deposited money and accounts from which a customer may draw on a line of credit. The limiting factor is that the account must be in a bank.

2. Paragraph (a)(3): "Banking day." Under this definition that part of a business day when a bank is open only for limited functions, e.g., to receive deposits and cash checks, but with loan, bookkeeping and other departments closed, is not part of a banking day.

3. Paragraph (a)(4): "Clearing house." Occasionally express companies, governmental agencies and other nonbanks deal directly with a clearing house; hence the definition does not limit the term to an association of banks.

4. Paragraph (a)(5): "Customer." It is to be noted that this term includes a bank carrying an account with another bank as well as the more typical nonbank customer or depositor.

5. Paragraph (a)(6): "Documentary draft" applies even though the documents do not accompany the draft but are to be received by the drawee or other payor before acceptance or payment of the draft.

6. Paragraph (a)(7): "Draft" is defined in Section 3-104 as a form of instrument. Since Article 4 applies to items that may not fall within the definition of instrument, the term is defined here to include an item that is a written order to pay money, even though the item may not qualify as an instrument. The term "order" is defined in Section 3-103.

7. Paragraph (a)(8): "Drawee" is defined in Section 3-103 in terms of an Article 3 draft which is a form of instrument. Here "drawee" is defined in terms of an Article 4 draft which includes items that may not be instruments.

8. Paragraph (a)(9): "Item" is defined broadly to include an instrument, as defined in Section 3-104, as well as promises or orders that may not be within the definition of "instrument." The terms "promise" and "order" are defined in Section 3-103. A promise is a written undertaking to pay money. An order is a written instruction to pay money. But see Section 4-110(c). Since bonds and other investment securities un-

der Article 8 may be within the term "instrument" or "promise," they are items and when handled by banks for collection are subject to this Article. See Comment 1 to Section 4-102. The functional limitation on the meaning of this term is the willingness of the banking system to handle the instrument, undertaking or instruction for collection or payment.

9. Paragraph (a)(10): "Midnight deadline." The use of this phrase is an example of the more mechanical approach used in this Article. Midnight is selected as a termination point or time limit to obtain greater uniformity and definiteness than would be possible from other possible terminating points, such as the close of the banking day or business day.

10. Paragraph (a)(11): The term "settle" has substantial importance throughout Article 4. In the American Bankers Association Bank Collection Code, in deferred posting statutes, in Federal Reserve regulations and operating circulars, in clearing-house rules, in agreements between banks and customers and in legends on deposit tickets and collection letters, there is repeated reference to "conditional" or "provisional" credits or payments. Tied in with this concept of credits or payments being in some way tentative, has been a related but somewhat different problem as to when an item is "paid" or "finally paid" either to determine the relative priority of the item as against attachments, stop-payment orders and the like or in insolvency situations. There has been extensive litigation in the various states on these problems. To a substantial extent the confusion, the litigation and even the resulting court decisions fail to take into account that in the collection process some debits or credits are provisional or tentative and others are final and that very many debits or credits are provisional or tentative for awhile but later become final. Similarly, some cases fail to recognize that within a single bank, particularly a payor bank, each item goes through a series of processes and that in a payor bank most of these processes are preliminary to the basic act of payment or "final payment."

The term "settle" is used as a convenient term to characterize a broad variety of conditional, provisional, tentative and also final payments of items. Such a comprehensive term is needed because it is frequently difficult or unnecessary to determine whether a particular action is tentative or final or when a particular credit shifts from the tentative class to the final class. Therefore, its use throughout the Article indicates that in that particular context it is unnecessary or unwise to determine whether the debit or the credit or the payment is tentative or final. However, if qualified by the adjective "provisional" its tentative nature is intended, and if qualified by the adjective "final" its permanent nature is intended.

Examples of the various types of settlement contemplated by the term include payments in cash; the efficient but somewhat complicated process of payment through the adjustment and offsetting of balances through clearing houses; debit or credit entries in accounts between banks; the forwarding of various types of remittance instruments, sometimes to cover a particular item but more frequently to cover an entire group of items received on a particular day.

11. Paragraph (a)(12): "Suspends payments." This term is designed to afford an objective test to determine when a bank is no longer operating as a part of the banking system.

ANNOTATION

Law reviews. For article, "Commercial Law", which discusses recent Tenth Circuit decisions dealing with questions of definition and interpretation, see 63 Den. U.L. Rev. 225 (1986).

4-4-105. "Bank" - "depositary bank" - "intermediary bank" - "collecting bank" - "payor bank" - "presenting bank". In this article:

(1) "Bank" means a person engaged in the business of banking, including a savings bank, savings and loan association, credit union, or trust company.

(2) "Depositary bank" means the first bank to take an item even though it is also the payor bank, unless the item is presented for immediate payment over the counter;

(3) "Payor bank" means a bank that is the drawee of a draft;

(4) "Intermediary bank" means a bank to which an item is transferred in course of collection except the depositary or payor bank;

(5) "Collecting bank" means a bank handling an item for collection except the payor bank;

(6) "Presenting bank" means a bank presenting an item except a payor bank.

Source: L. 94: Entire article amended with relocations, p. 883, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. The definitions in general exclude a bank to which an item is issued, as this bank does not take by transfer except in the particular case covered in which the item is issued to a payee for collection, as in the case in which a corporation is transferring balances from one account to another. Thus, the definition of "depositary bank" does not include the bank to which a check is made payable if a check is given in payment of a mortgage. This bank has the status of a payee under Article 3 on Negotiable Instruments and not that of a collecting bank.

2. Paragraph (1): "Bank" is defined in Section 1-201(4) as meaning "any person engaged in the business of banking." The definition in paragraph (1) makes clear that "bank" includes savings banks, savings and loan associations, credit unions and trust companies, in addition to the commercial banks commonly denoted by use of the term "bank."

3. Paragraph (2): A bank that takes an "on us" item for collection, for application to a customer's loan, or first handles the item for other reasons is a depositary bank even though it is also the payor bank. However, if the holder presents the item for immediate payment over the counter, the payor bank is not a depositary bank.

4. Paragraph (3): The definition of "payor bank" is clarified by use of the term "drawee." That term is defined in Section 4-104 as meaning "a person ordered in a draft to make payment." An "order" is defined in Section 3-103 as meaning "a written instruction to pay money ... . An authorization to pay is not an order unless the person authorized to pay is also instructed to pay." The definition of order is incorporated into Article 4 by Section 4-104(c). Thus a payor bank is one instructed to pay in the item. A bank does not become a payor bank by being merely authorized to pay or by being given an instruction to pay not contained in the item.

5. Paragraph (4): The term "intermediary bank" includes the last bank in the collection process if the drawee is not a bank. Usually the last bank is also a presenting bank.

ANNOTATION

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974). For article, "Let the Payor Beware: Dishonoring Documentary Drafts", see 20 Colo. Law. 2263 (1991).

Language of an instrument determines whether a bank is a "collecting bank" or a "payor bank". Accordingly where the language of a sight draft designated a bank as a "collecting bank", its liability for mishandling of the draft was limited to the face value of the draft under § 4-4-103. Shelby Res., LLC v. Wells Fargo Bank, 160 P.3d 387 (Colo. App. 2007).

4-4-106. Payable through or payable at bank - collecting bank. (a) If an item states that it is "payable through" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.

(b) If an item states that it is "payable at" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.

(c) If a draft names a nonbank drawee and it is unclear whether a bank named in the draft is a co-drawee or a collecting bank, the bank is a collecting bank.

Source: L. 94: Entire article amended with relocations, p. 883, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. This section replaces former Sections 3-120 and 3-121. Some items are made "payable through" a particular bank. Subsection (a) states that such language makes the bank a collecting bank and not a payor bank. An item identifying a "payable through" bank can be presented for payment to the drawee only by the "payable through" bank. The item cannot be presented to the drawee over the counter for immediate payment or by a collecting bank other than the "payable through" bank.

2. Subsection (b) retains the alternative approach of the present law. Under Alternative A a note payable at a bank is the equivalent of a

draft drawn on the bank and the midnight deadline provisions of Sections 4-301 and 4-302 apply. Under Alternative B a "payable at" bank is in the same position as a "payable through" bank under subsection (a).

3. Subsection (c) rejects the view of some cases that a bank named below the name of a drawee is itself a drawee. The commercial understanding is that this bank is a collecting bank and is not accountable under Section 4-302 for holding an item beyond its deadline. The liability of the bank is governed by Sections 4-202(a) and 4-103(e).

4-4-107. Separate office of bank. A branch or separate office of a bank is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders must be given under this article and under article 3 of this title.

Source: L. 94: Entire article amended with relocations, p. 884, § 2, effective January 1, 1995.

Editor's note - Colorado legislative change: (1) This section is similar to former § 4-4-106 as it existed prior to 1994, and the former § 4-4-107 was relocated to § 4-4-108.

(2) After the first word "bank", Colorado did not adopt the following: "maintaining its own deposit ledgers".

OFFICIAL COMMENT

1. A rule with respect to the status of a branch or separate office of a bank as a part of any statute on bank collections is highly desirable if not absolutely necessary. However, practices in the operations of branches and separate offices vary substantially in the different states and it has not been possible to find any single rule that is logically correct, fair in all situations and workable under all different types of practices. The decision not to draft the section with greater specificity leaves to the courts the resolution of the issues arising under this section on the basis of the facts of each case.

2. In many states and for many purposes a branch or separate office of the bank should be treated as a separate bank. Many branches function as separate banks in the handling and payment of items and require time for doing so similar to that of a separate bank. This is particularly true if branch banking is permitted throughout a state or in different towns and cities. Similarly, if there is this separate functioning a particular branch or separate office is the only proper place for various types of action to be taken or orders or notices to be given. Examples include the drawing of a check on a particular branch by a customer whose account is carried at that branch; the presentment of that same check at that branch; the issuance of an order to the branch to stop payment on the check.

3. Section 1 of the American Bankers Association Bank Collection Code provided simply: "A branch or office of any such bank shall be deemed a bank." Although this rule appears to be brief and simple, as applied to particular sections of the ABA Code it produces illogical and, in some cases, unreasonable results. For example, under Section 11 of the ABA Code it seems anomalous for one branch of a bank to have charged an item to the account of the drawer and another branch to have the power to elect to treat the item as dishonored. Similar logical problems would flow from applying the same rule to Article 4. Warranties by one branch to another branch under Sections 4-207 and 4-208 (each considered a separate bank) do not make sense.

4. Assuming that it is not desirable to make each branch a separate bank for all purposes, this section provides that a branch or separate office is a separate bank for certain purposes. In so doing the single legal entity of the bank as a whole is preserved, thereby carrying with it the liability of the institution as a whole on such obligations as it may be under. On the other hand, in cases in which the Article provides a number of time limits for different types of action by banks, if a branch functions as a separate bank, it should have the time limits available to a separate bank. Similarly if in its relations to customers a branch functions as a separate bank, notices and orders with respect to accounts of customers of the branch should be given at the branch. For example, whether a branch has notice sufficient to affect its status as a holder in due course of an item taken by it should depend upon what notice that branch has received with respect to the item. Similarly the receipt of a stop-payment order at one branch should not be notice to another branch so as to impair the right of the second branch to be a holder in due course of the item, although in circumstances in which ordinary care requires the communication of a notice or order to the proper branch of a bank, the notice or order

would be effective at the proper branch from the time it was or should have been received. See Section 1-201(27).

5. The bracketed language ("maintaining its own deposit ledger") in former Section 4-106 is deleted. Today banks keep records on customer accounts by electronic data storage. This has led most banks with branches to centralize to some degree their record keeping. The place where records are kept has little meaning if the information is electronically stored and is instantly retrievable at all branches of the bank. Hence, the inference to be drawn from the deletion of the bracketed language is that where record keeping is done is no longer an important factor in determining whether a branch is a separate bank.

4-4-108. Time of receipt of items. (a) For the purpose of allowing time to process items, prove balances, and make the necessary entries on its books to determine its position for the day, a bank may fix an afternoon hour of 2 p.m. or later as a cutoff hour for the handling of money and items and the making of entries on its books.

(b) An item or deposit of money received on any day after a cutoff hour so fixed or after the close of the banking day may be treated as being received at the opening of the next banking day.

Source: L. 94: Entire article amended with relocations, p. 884, § 2, effective January 1, 1995.

Editor's note: This section is similar to former § 4-4-107 as it existed prior to 1994, and the former § 4-4-108 was relocated to § 4-4-109.

OFFICIAL COMMENT

1. Each of the huge volume of checks processed each day must go through a series of accounting procedures that consume time. Many banks have found it necessary to establish a cutoff hour to allow time for these procedures to be completed within the time limits imposed by Article 4. Subsection (a) approves a cutoff hour of this type provided it is not earlier than 2 P.M. Subsection (b) provides that if such a cutoff hour is fixed, items received after the cutoff hour may be treated as being received at the opening of the next banking day. If the number of items received either through the mail or over the counter tends to taper off radically as the afternoon hours progress, a 2 P.M. cutoff hour does not involve a large portion of the items received but at the same time permits a bank using such a cutoff hour to leave its doors open later in the afternoon without forcing into the evening the completion of its settling and proving process.

2. The provision in subsection (b) that items or deposits received after the close of the banking day may be treated as received at the opening of the next banking day is important in cases in which a bank closes at twelve or one o'clock, e.g., on a Saturday, but continues to receive some items by mail or over the counter if, for example, it opens Saturday evening for the limited purpose of receiving deposits and cashing checks.

4-4-109. Delays. (a) Unless otherwise instructed, a collecting bank in a good faith effort to secure payment of a specific item drawn on a payor other than a bank, and with or without the approval of any person involved, may waive, modify, or extend time limits imposed or permitted by this title for a period not exceeding two additional banking days without discharge of drawers or indorsers or liability to its transferor or a prior party.

(b) Delay by a collecting bank or payor bank beyond time limits prescribed or permitted by this title or by instructions is excused if (i) the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank, and (ii) the bank exercises such diligence as the circumstances require.

Source: L. 94: Entire article amended with relocations, p. 884, § 2, effective January 1, 1995.

Editor's note: This section is similar to former § 4-4-108 as it existed prior to 1994, and the former § 4-4-109 was relocated to § 4-4-110.

OFFICIAL COMMENT

1. Sections 4-202(b), 4-214, 4-301, and 4-302 prescribe various time limits for the handling of items. These are the limits of time within which a bank, in fulfillment of its obligation to exercise ordinary care, must handle items entrusted to it for collection or payment. Under Section 4-103 they may be varied by agreement or by Federal Reserve regulations or operating circular, clearing-house rules, or the like. Subsection (a) permits a very limited extension of these time limits. It authorizes a collecting bank to take additional time in attempting to collect drafts drawn on nonbank payors with or without the approval of any interested party. The right of a collecting bank to waive time limits under subsection (a) does not apply to checks. The two-day extension can only be granted in a good faith effort to secure payment and only with respect to specific items. It cannot be exercised if the customer instructs otherwise. Thus limited the escape provision should afford a limited degree of flexibility in special cases but should not interfere with the overall requirement and objective of speedy collections.

2. An extension granted under subsection (a) is without discharge of drawers or indorsers. It therefore extends the times for presentment or payment as specified in Article 3.

3. Subsection (b) is another escape clause from time limits. This clause operates not only with respect to time limits imposed by the Article itself but also time limits imposed by special instructions, by agreement or by Federal regulations or operating circulars, clearing-house rules or the like. The latter time limits are "permitted" by the Code. For example, a payor bank that fails to make timely return of a dishonored item may be accountable for the amount of the item. Subsection (b) excuses a bank from this liability when its failure to meet its midnight deadline resulted from, for example, a computer breakdown that was beyond the control of the bank, so long as the bank exercised the degree of diligence that the circumstances required. In **Port City State Bank v. American National Bank**, 486 F.2d 196 (10th Cir. 1973), the court held that a bank exercised sufficient diligence to be excused under this subsection. If delay is sought to be excused under this subsection, the bank has the burden of proof on the issue of whether it exercised "such diligence as the circumstances require." The subsection is consistent with Regulation CC, Section 229.38(e).

4-4-110. Electronic presentment. (a) "Agreement for electronic presentment" means an agreement, clearing-house rule, or federal reserve regulation or operating circular, providing that presentment of an item may be made by transmission of an image of an item or information describing the item ("presentment notice") rather than delivery of the item itself. The agreement may provide for procedures governing retention, presentment, payment, dishonor, and other matters concerning items subject to the agreement.

(b) Presentment of an item pursuant to an agreement for presentment is made when the presentment notice is received.

(c) If presentment is made by presentment notice, a reference to "item" or "check" in this article means the presentment notice unless the context otherwise indicates.

Source: L. 94: Entire article amended with relocations, p. 884, § 2, effective January 1, 1995.

Editor's note: This section is similar to former § 4-4-109 as it existed prior to 1994.

OFFICIAL COMMENT

1. "An agreement for electronic presentment" refers to an agreement under which presentment may be made to a payor bank by a presentment notice rather than by presentment of the item. Under imaging technology now under development, the presentment notice might be an image of the item. The electronic presentment agreement may provide that the item may be retained by a depositary bank, other collecting bank, or even a customer of the depositary bank, or it may provide that the item will follow the presentment notice. The identifying characteristic of an electronic presentment agreement is that presentment occurs when the presentment notice is received. "An agreement for electronic presentment" does not refer to the common case of retention of items by payor banks because the item itself is presented to the payor bank in these cases. Payor bank check retention is a matter of agreement between payor banks and their customers. Provisions on payor bank check retention are found in Section 4-406(b).

2. The assumptions under which the electronic presentment amendments are based are as follows: No bank will participate in an elec-

tronic presentment program without an agreement. These agreements may be either bilateral (Section 4-103(a)), under which two banks that frequently do business with each other may agree to depositary bank check retention, or multilateral (Section 4-103(b)), in which large segments of the banking industry may participate in such a program. In the latter case, federal or other uniform regulatory standards would likely supply the substance of the electronic presentment agreement, the application of which could be triggered by the use of some form of identifier on the item. Regulation CC, Section 229.36(c) authorizes truncation agreements but forbids them from extending return times or otherwise varying requirements of the part of Regulation CC governing check collection without the agreement of all parties interested in the check. For instance, an extension of return time could damage a depositary bank which must make funds available to its customers under mandatory availability schedules. The Expedited Funds Availability Act, 12 U.S.C. Section 4008(b)(2), directs the Federal Reserve Board to consider requiring that banks provide for check truncation.

3. The parties affected by an agreement for electronic presentment, with the exception of the customer, can be expected to protect themselves. For example, the payor bank can probably be expected to limit its risk of loss from drawer forgery by limiting the dollar amount of eligible items (Federal Reserve program), by reconcilement agreements (ABA Safekeeping program), by insurance (credit union share draft program), or by other means. Because agreements will exist, only minimal amendments are needed to make clear that the UCC does not prohibit electronic presentment.

4-4-111. Statute of limitations. An action to enforce an obligation, duty, or right arising under this article must be commenced within three years after the cause of action accrues.

Source: L. 94: Entire article amended with relocations, p. 885, § 2, effective January 1, 1995.

OFFICIAL COMMENT

This section conforms to the period of limitations set by Section 3-118(g) for actions for breach of warranty and to enforce other obligations, duties or rights arising under Article 3. Bracketing "cause of action" recognizes that some states use a different term, such as "claim for relief."

PART 2

COLLECTION OF ITEMS - DEPOSITARY AND COLLECTING BANKS

4-4-201. Status of collecting banks as agent and provisional status of credits - applicability of article - item indorsed "pay any bank". (a) Unless a contrary intent clearly appears and before the time that a settlement given by a collecting bank for an item is or becomes final, the bank, with respect to the item, is an agent or subagent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank such as those resulting from outstanding advances on the item and rights of recoupment or setoff. If an item is handled by banks for purposes of presentment, payment, collection, or return, the relevant provisions of this article apply even though action of the parties clearly establishes that a particular bank has purchased the item and is the owner of it.

(b) After an item has been indorsed with the words "pay any bank" or the like, only a bank may acquire the rights of a holder until the item has been:

(1) Returned to the customer initiating collection; or

(2) Specially indorsed by a bank to a person who is not a bank.

Source: L. 94: Entire article amended with relocations, p. 885, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. This section states certain basic rules of the bank collection process. One basic rule, appearing in the last sentence of subsection (a), is that, to the extent applicable, the provisions of the Article govern without regard to whether a bank handling an item owns the item or is an agent for collection. Historically, much time has been spent and effort expended in determining or attempting to determine whether a bank was a purchaser of an item or merely an agent for collection. See discussion of this subject and cases cited in 11 A.L.R. 1043, 16 A.L.R. 1084, 42 A.L.R. 492, 68 A.L.R. 725, 99 A.L.R. 486. See also Section 4 of the American Bankers Association Bank Collection Code. The general approach of Article 4, similar to that of other articles, is to provide, within reasonable limits, rules or answers to major problems known to exist in the bank collection process without regard to questions of status and ownership but to keep general principles such as status and ownership available to cover residual areas not covered by specific rules. In line with this approach, the last sentence of subsection (a) says in effect that Article 4 applies to practically every item moving through banks for the purpose of presentment, payment or collection.

2. Within this general rule of broad coverage, the first two sentences of subsection (a) state a rule of agency status. "Unless a contrary intent clearly appears" the status of a collecting bank is that of an agent or sub-agent for the owner of the item. Although as indicated in Comment 1 it is much less important under Article 4 to determine status than has been the case heretofore, status may have importance in some residual areas not covered by specific rules. Further, since status has been considered so important in the past, to omit all reference to it might cause confusion. The status of agency "applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn." Thus questions heretofore litigated as to whether ordinary indorsements "for deposit," "for collection" or in blank have the effect of creating an agency status or a purchase, no longer have significance in varying the prima facie rule of agency. Similarly, the nature of the credit given for an item or whether it is subject to immediate withdrawal as of right or is in fact withdrawn, does not alter the agency status. See A.L.R. references supra in Comment 1.

A contrary intent can change agency status but this must be clear. An example of a clear contrary intent would be if collateral papers established or the item bore a legend stating that the item was sold absolutely to the depositary bank.

3. The prima facie agency status of collecting banks is consistent with prevailing law and practice today. Section 2 of the American Bankers Association Bank Collection Code so provided. Legends on deposit tickets, collection letters and acknowledgments of items and Federal Reserve operating circulars consistently so provide. The status is consistent with rights of charge-back (Section 4-214 and Section 11 of the ABA Code) and risk of loss in the event of insolvency (Section 4-216 and Section 13 of the ABA Code). The right of charge-back with respect to checks is limited by Regulation CC, Section 226.36(d).

4. Affirmative statement of a prima facie agency status for collecting banks requires certain limitations and qualifications. Under current practices substantially all bank collections sooner or later merge into bank credits, at least if collection is effected. Usually, this takes place within a few days of the initiation of collection. An intermediary bank receives final collection and evidences the result of its collection by a "credit" on its books to the depositary bank. The depositary bank evidences the results of its collection by a "credit" in the account of its customer. As used in these instances the term "credit" clearly indicates a debtor-creditor relationship. At some stage in the bank collection process the agency status of a collecting bank changes to that of debtor, a debtor of its customer. Usually at about the same time it also becomes a creditor for the amount of the item, a creditor of some intermediary, payor or other bank. Thus the collection is completed, all agency aspects are terminated and the identity of the item has become completely merged in bank accounts, that of the customer with the depositary bank and that of one bank with another.

Although Section 4-215(a) provides that an item is finally paid when the payor bank takes or fails to take certain action with respect to the item, the final payment of the item may or may not result in the simultaneous final settlement for the item in the case of all prior parties. If a series of provisional debits and credits for the item have been entered in accounts between banks, the final payment of the item by the payor bank may result in the automatic firming up of all these provisional debits and credits under Section 4-215(c), and the consequent receipt of final settlement for the item by each collecting bank and the customer of the depositary bank simultaneously with such action of the payor bank. However, if the payor bank or some intermediary bank accounts for the item with a remittance draft, the next prior bank usually does not receive final settlement for the item until the remittance draft finally clears. See Section 4-213(c). The first sentence of subsection (a) provides that the agency status of a collecting bank (whether intermediary or depositary)

continues until the settlement given by it for the item is or becomes final. In the case of the series of provisional credits covered by Section 4-215(c), this could be simultaneously with the final payment of the item by the payor bank. In cases in which remittance drafts are used or in straight noncash collections, this would not be until the times specified in Sections 4-213(c) and 4-215(d). With respect to checks Regulation CC Sections 229.31(c), 229.32(b), and 229.36(d) provide that all settlements between banks are final in both the forward collection and return of checks.

Under Section 4-213(a) settlements for items may be made by any means agreed to by the parties. Since it is impossible to contemplate all the kinds of settlements that will be utilized, no attempt is made in Article 4 to provide when settlement is final in all cases. The guiding principle is that settlements should be final when the presenting person has received usable funds. Section 4-213(c) and (d) and Section 4-215(c) provide when final settlement occurs with respect to certain kinds of settlement, but these provisions are not intended to be exclusive.

A number of practical results flow from the rule continuing the agency status of a collecting bank until its settlement for the item is or becomes final, some of which are specifically set forth in this Article. One is that risk of loss continues in the owner of the item rather than the agent bank. See Section 4-214. Offsetting rights favorable to the owner are that pending such final settlement, the owner has the preference rights of Section 4-216 and the direct rights of Section 4-302 against the payor bank. It also follows from this rule that the dollar limitations of Federal Deposit Insurance are measured by the claim of the owner of the item rather than that of the collecting bank. With respect to checks, rights of the parties in insolvency are determined by Regulation CC Section 229.39 and the liability of a bank handling a check to a subsequent bank that does not receive payment because of suspension of payments by another bank is stated in Regulation CC Section 229.35(b).

5. In those cases in which some period of time elapses between the final payment of the item by the payor bank and the time that the settlement of the collecting bank is or becomes final, e.g., if the payor bank or an intermediary bank accounts for the item with a remittance draft or in straight noncash collections, the continuance of the agency status of the collecting bank necessarily carries with it the continuance of the owner's status as principal. The second sentence of subsection (a) provides that whatever rights the owner has to proceeds of the item are subject to the rights of collecting banks for outstanding advances on the item and other valid rights, if any. The rule provides a sound rule to govern cases of attempted attachment of proceeds of a noncash item in the hands of the payor bank as property of the absent owner. If a collecting bank has made an advance on an item which is still outstanding, its right to obtain reimbursement for this advance should be superior to the rights of the owner to the proceeds or to the rights of a creditor of the owner. An intentional crediting of proceeds of an item to the account of a prior bank known to be insolvent, for the purpose of acquiring a right of setoff, would not produce a valid setoff. See 8 Zollman, Banks and Banking (1936) Sec. 5443.

6. This section and Article 4 as a whole represent an intentional abandonment of the approach to bank collection problems appearing in Section 4 of the American Bankers Association Bank Collection Code. Because the tremendous volume of items handled makes impossible the examination by all banks of all indorsements on all items and thus in fact this examination is not made, except perhaps by depositary banks, it is unrealistic to base the rights and duties of all banks in the collection chain on variations in the form of indorsements. It is anomalous to provide throughout the ABA Code that the prima facie status of collecting banks is that of agent or sub-agent but in Section 4 to provide that subsequent holders (sub-agents) shall have the right to rely on the presumption that the bank of deposit (the primary agent) is the owner of the item. It is unrealistic, particularly in this background, to base rights and duties on status of agent or owner. Thus Section 4-201 makes the pertinent provisions of Article 4 applicable to substantially all items handled by banks for presentment, payment or collection, recognizes the prima facie status of most banks as agents, and then seeks to state appropriate limits and some attributes to the general rules so expressed.

7. Subsection (b) protects the ownership rights with respect to an item indorsed "pay any bank or banker" or in similar terms of a customer initiating collection or of any bank acquiring a security interest under Section 4-210, in the event the item is subsequently acquired under improper circumstances by a person who is not a bank and transferred by that person to another person, whether or not a bank. Upon return to the customer initiating collection of an item so indorsed, the indorsement may be cancelled (Section 3-207). A bank holding an item so indorsed may transfer the item out of banking channels by special indorsement; however, under Section 4-103(e), the bank would be liable to the owner of the item for any loss resulting therefrom if the transfer had been made in bad faith or with lack of ordinary care. If briefer and more simple forms of bank indorsements are developed under Section 4-206 (e.g., the use of bank transit numbers in lieu of present lengthy forms of bank indorsements), a depositary bank having the transit number "X100" could make subsection (b) operative by indorsements such

as "Pay any bank—X100." Regulation CC Section 229.35(c) states the effect of an indorsement on a check by a bank.

ANNOTATION

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974). For article, "Commercial Law", which discusses recent Tenth Circuit decisions dealing with questions of definition and interpretation, see 63 Den. U.L. Rev. 225 (1986).

When risk of loss remains on depositor. Where one indorses a check payable to him and deposits it in a bank, the bank credits the money to the account, and the depositor withdraws the full amount, but subsequently the foreign payor bank refuses to honor the check, the depositor is still the owner of the check, the bank is the agent for collection, and the credit given for the deposit is only provisional; therefore, the risk of loss on the check remains on the depositor. Mercantile Bank & Trust Co. v. Hunter, 31 Colo. App. 200, 501 P.2d 486 (1972).

4-4-202. Responsibility for collection or return - when action timely. (a) A collecting bank must exercise ordinary care in:

(1) Presenting an item or sending it for presentment;

(2) Sending notice of dishonor or nonpayment or returning an item other than a documentary draft to the bank's transferor after learning that the item has not been paid or accepted, as the case may be;

(3) Settling for an item when the bank receives final settlement; and

(4) Notifying its transferor of any loss or delay in transit within a reasonable time after discovery thereof.

(b) A collecting bank exercises ordinary care under subsection (a) of this section by taking proper action before its midnight deadline following receipt of an item, notice, or settlement. Taking proper action within a reasonably longer time may constitute the exercise of ordinary care, but the bank has the burden of establishing timeliness.

(c) Subject to subsection (a) (1) of this section, a bank is not liable for the insolvency, neglect, misconduct, mistake, or default of another bank or person or for loss or destruction of an item in the possession of others or in transit.

Source: L. 94: Entire article amended with relocations, p. 886, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. Subsection (a) states the basic responsibilities of a collecting bank. Of course, under Section 1-203 a collecting bank is subject to the standard requirement of good faith. By subsection (a) it must also use ordinary care in the exercise of its basic collection tasks. By Section 4-103(a) neither requirement may be disclaimed.

2. If the bank makes presentment itself, subsection (a)(1) requires ordinary care with respect both to the time and manner of presentment. (Sections 3-501 and 4-212.) If it forwards the item to be presented the subsection requires ordinary care with respect to routing (Section 4-204), and also in the selection of intermediary banks or other agents.

3. Subsection (a) describes types of basic action with respect to which a collecting bank must use ordinary care. Subsection (b) deals with the time for taking action. It first prescribes the general standard for timely action, namely, for items received on Monday, proper action (such as forwarding or presenting) on Monday or Tuesday is timely. Although under current "production line" operations banks customarily move items along on regular schedules substantially briefer than two days, the subsection states an outside time within which a bank may know it has taken timely action. To provide flexibility from this standard norm, the subsection further states that action within a reasonably longer time may be timely but the bank has the burden of proof. In the case of time items, action after the midnight deadline, but sufficiently in advance of maturity for proper presentation, is a clear example of a "reasonably longer time" that is timely. The standard of requiring action not later than Tuesday in the case of Monday items is also subject to possibilities of variation under the general provisions of Section 4-103, or under the special provisions regarding time of receipt of items (Section 4-108), and regarding

delays (Section 4-109). This subsection (b) deals only with collecting banks. The time limits applicable to payor banks appear in Sections 4-301 and 4-302.

4. At common law the so-called New York collection rule subjected the initial collecting bank to liability for the actions of subsequent banks in the collection chain; the so-called Massachusetts rule was that each bank, subject to the duty of selecting proper intermediaries, was liable only for its own negligence. Subsection (c) adopts the Massachusetts rule. But since this is stated to be subject to subsection (a)(1) a collecting bank remains responsible for using ordinary care in selecting properly qualified intermediary banks and agents and in giving proper instructions to them. Regulation CC Section 229.36(d) states the liability of a bank during the forward collection of checks.

ANNOTATION

This section displaces common law negligence claims applicable to bank deposits and collections because it requires a failure to exercise ordinary care and causation almost, if not totally, identical to that which a common law negligence claim would require. Shelby Res., LLC v. Wells Fargo Bank, 160 P.3d 387 (Colo. App. 2007).

4-4-203. Effect of instructions. Subject to article 3 of this title concerning conversion of instruments (section 4-3-420) and restrictive indorsements (section 4-3-206), only a collecting bank's transferor can give instructions that affect the bank or constitute notice to it, and a collecting bank is not liable to prior parties for any action taken pursuant to the instructions or in accordance with any agreement with its transferor.

Source: L. 94: Entire article amended with relocations, p. 886, § 2, effective January 1, 1995.

OFFICIAL COMMENT

This section adopts a "chain of command" theory which renders it unnecessary for an intermediary or collecting bank to determine whether its transferor is "authorized" to give the instructions. Equally the bank is not put on notice of any "revocation of authority" or "lack of authority" by notice received from any other person. The desirability of speed in the collection process and the fact that, by reason of advances made, the transferor may have the paramount interest in the item requires the rule.

The section is made subject to the provisions of Article 3 concerning conversion of instruments (Section 3-420) and restrictive indorsements (Section 3-206). Of course instructions from or an agreement with its transferor does not relieve a collecting bank of its general obligation to exercise good faith and ordinary care. See Section 4-103(a). If in any particular case a bank has exercised good faith and ordinary care and is relieved of responsibility by reason of instructions of or an agreement with its transferor, the owner of the item may still have a remedy for loss against the transferor (another bank) if such transferor has given wrongful instructions.

The rules of the section are applied only to collecting banks. Payor banks always have the problem of making proper payment of an item; whether such payment is proper should be based upon all of the rules of Articles 3 and 4 and all of the facts of any particular case, and should not be dependent exclusively upon instructions from or an agreement with a person presenting the item.

4-4-204. Methods of sending and presenting - sending directly to payor bank. (a) A collecting bank shall send items by a reasonably prompt method, taking into consideration relevant instructions, the nature of the item, the number of those items on hand, the cost of collection involved, and the method generally used by it or others to present those items.

(b) A collecting bank may send:

(1) An item directly to the payor bank;

(2) An item to a nonbank payor if authorized by its transferor; and

(3) An item other than documentary drafts to a nonbank payor, if authorized by federal reserve regulation or operating circular, clearing-house rule, or the like.

(c) Presentment may be made by a presenting bank at a place where the payor bank or other payor has requested that presentment be made.

Source: L. 94: Entire article amended with relocations, p. 886, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. Subsection (a) prescribes the general standards applicable to proper sending or forwarding of items. Because of the many types of methods available and the desirability of preserving flexibility any attempt to prescribe limited or precise methods is avoided.

2. Subsection (b)(1) codifies the practice of direct mail, express, messenger or like presentment to payor banks. The practice is now country-wide and is justified by the need for speed, the general responsibility of banks, Federal Deposit Insurance protection and other reasons.

3. Full approval of the practice of direct sending is limited to cases in which a bank is a payor. Since nonbank drawees or payors may be of unknown responsibility, substantial risks may be attached to placing in their hands the instruments calling for payments from them. This is obviously so in the case of documentary drafts. However, in some cities practices have long existed under clearing-house procedures to forward certain types of items to certain nonbank payors. Examples include insurance loss drafts drawn by field agents on home offices. For the purpose of leaving the door open to legitimate practices of this kind, subsection (b)(3) affirmatively approves direct sending of any item other than documentary drafts to any nonbank payor, if authorized by Federal Reserve regulation or operating circular, clearing-house rule or the like.

On the other hand subsection (b)(2) approves sending any item directly to a nonbank payor if authorized by a collecting bank's transferor. This permits special instructions or agreements out of the norm and is consistent with the "chain of command" theory of Section 4-203. However, if a transferor other than the owner of the item, e.g., a prior collecting bank, authorizes a direct sending to a nonbank payor, such transferor assumes responsibility for the propriety or impropriety of such authorization.

4. Section 3-501(b) provides where presentment may be made. This provision is expressly subject to Article 4. Section 4-204(c) specifically approves presentment by a presenting bank at any place requested by the payor bank or other payor. The time when a check is received by a payor bank for presentment is governed by Regulation CC Section 229.36(b).

4-4-205. Depositary bank holder of unindorsed item. If a customer delivers an item to a depositary bank for collection:

(1) The depositary bank becomes a holder of the item at the time it receives the item for collection if the customer at the time of delivery was a holder of the item, whether or not the customer indorses the item, and, if the bank satisfies the other requirements of section 4-3-302, it is a holder in due course; and

(2) The depositary bank warrants to collecting banks, the payor bank or other payor, and the drawer that the amount of the item was paid to the customer or deposited to the customer's account.

Source: L. 94: Entire article amended with relocations, p. 887, § 2, effective January 1, 1995.

OFFICIAL COMMENT

Section 3-201(b) provides that negotiation of an instrument payable to order requires indorsement by the holder. The rule of former Section 4-205(1) was that the depositary bank may supply a missing indorsement of its customer unless the item contains the words "payee's indorsement required" or the like. The cases have differed on the status of the depositary bank as a holder if it fails to supply its customer's indorsement. **Marine Midland Bank, N.A. v. Price, Miller, Evans & Flowers,** 446 N.Y.S.2d 797 (N.Y.Apo. Div.4th Dept. 1981), **rev'd,** 455 N.Y.S.2d 565 (N.Y. 1982). It is common practice for depositary banks to receive unindorsed checks under so-called "lock-box" agreements from customers who receive a high volume of checks. No function would be served by requiring a depositary bank to run these items through a machine that would supply the customer's indorsement except to afford the drawer and the subsequent banks evidence that the proceeds of the item reached the customer's account. Para-

graph (1) provides that the depositary bank becomes a holder when it takes the item for deposit if the depositor is a holder. Whether it supplies the customer's indorsement is immaterial. Paragraph (2) satisfies the need for a receipt of funds by the depositary bank by imposing on that bank a warranty that it paid the customer or deposited the item to the customer's account. This warranty runs not only to collecting banks and to the payor bank or nonbank drawee but also to the drawer, affording protection to these parties that the depositary bank received the item and applied it to the benefit of the holder.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Liability of indorser where estoppel created. While the principle that an indorser is liable on his warranty is correctly stated, the rule has no application when an estoppel has been created which would preclude plaintiff from obtaining a refund of the amount paid to defendant. First Nat'l Bank v. Ulibarri, 38 Colo. App. 428, 557 P.2d 1221 (1976).

Subsection (1) under former law held inapplicable where the depository bank did not in fact place a statement on the item to be collected, which statement would have been effective as its customer's indorsement. La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

It was impossible for bank to provide indorsement on check because payee was not the bank's customer. The indorsement by the bank was unauthorized as a matter of law. Kelly v. Central Bank and Trust Co., 794 P.2d 1037 (Colo. App. 1989).

Subsection (1) under former law does not permit depository bank to evade duties imposed by § 4-3-206(3) under former law. Subsection (1) does not permit a depository bank to evade its duty to act consistently with restrictive endorsements as provided by § 4-3-206 (3). La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

The duty to examine a restrictive indorsement and follow its directions may require a bank to refuse to deposit an item in a particular account if such conduct would be inconsistent with the restrictive indorsement, or to investigate rather than accept an item as a matter of course. La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

Subsection (2) under former law not in conflict with requirements of § 4-3-206 (2) under former law. The clear import of both subsection (2) and § 4-3-206 (2) is that while intermediary banks and nondepository payor banks may ignore all restrictive indorsements except those of the bank's immediate transferor, depository banks may not so ignore restrictive indorsements. La Junta State Bank v. Travis, 727 P.2d 48 (Colo. 1986).

4-4-206. Transfer between banks. Any agreed method that identifies the transferor bank is sufficient for the item's further transfer to another bank.

Source: L. 94: Entire article amended with relocations, p. 887, § 2, effective January 1, 1995.

OFFICIAL COMMENT

This section is designed to permit the simplest possible form of transfer from one bank to another, once an item gets in the bank collection chain, provided only identity of the transferor bank is preserved. This is important for tracing purposes and if recourse is necessary. However, since the responsibilities of the various banks appear in the Article it becomes unnecessary to have liability or responsibility depend on more formal indorsements. Simplicity in the form of transfer is conducive to speed. If the transfer is between banks, this section takes the place of the more formal requirements of Section 3-201.

4-4-207. Transfer warranties. (a) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that:

(1) The warrantor is a person entitled to enforce the item;

(2) All signatures on the item are authentic and authorized;

(3) The item has not been altered;

(4) The item is not subject to a defense or claim in recoupment (section 4-3-305 (a)) of any party that can be asserted against the warrantor;

(5) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer; and

(6) If the item is a demand draft, creation of the item according to the terms on its face was authorized by the person identified as drawer. Nothing in this section shall be construed to impair the rights of the drawer against the drawee.

(b) If an item is dishonored, a customer or collecting bank transferring the item and receiving settlement or other consideration is obliged to pay the amount due on the item (i) according to the terms of the item at the time it was transferred, or (ii) if the transfer was of an incomplete item, according to its terms when completed as stated in sections 4-3-115 and 4-3-407. The obligation of a transferor is owed to the transferee and to any subsequent collecting bank that takes the item in good faith. A transferor cannot disclaim its obligation under this subsection (b) by an indorsement stating that it is made "without recourse" or otherwise disclaiming liability.

(c) A person to whom the warranties under subsection (a) of this section are made and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the item plus expenses and loss of interest incurred as a result of the breach.

(d) The warranties stated in subsection (a) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within thirty days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(e) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(f) If the warranty in paragraph (6) of subsection (a) of this section is not given by a transferor or collecting bank under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee, nor to any prior collecting bank of that transferee.

Source: L. 94: Entire article amended with relocations, p. 887, § 2, effective January 1, 1995. **L. 2001:** (a) amended and (f) added, p. 868, § 6, effective August 8.

Cross references: For the legislative declaration contained in the 2001 act amending subsection (a) and enacting subsection (f), see section 1 of chapter 244, Session Laws of Colorado 2001.

OFFICIAL COMMENT

Except for subsection (b), this section conforms to Section 3-416 and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3-416. Subsection (b) provides that customers or collecting banks that transfer items, whether by indorsement or not, undertake to pay the item if the item is dishonored. This obligation cannot be disclaimed by a "without recourse" indorsement or otherwise. With respect to checks, Regulation CC Section 229.34 states the warranties made by paying and returning banks.

ANNOTATION

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Liability of indorser where estoppel created. While the principle that an indorser is liable on his warranty is correctly stated, the rule has no application when an estoppel has been created which would preclude plaintiff from obtaining a refund of the amount paid to defendant. First Nat'l Bank v. Ulibarri, 38 Colo. App. 428, 557 P.2d 1221 (1976).

Payee may not maintain action against depositary bank on the basis of either this section under former law or § 4-3-417 under former law. Nat'l Sur. Corp. v. Citizens State Bank, 41 Colo. App. 580, 593 P.2d 362 (1978), aff'd, 199 Colo. 497, 612 P.2d 70 (1980).

A bank that accepts and pays a check with an unauthorized or forged endorsement warrants to subsequent transferees the validity of

that endorsement and may be held liable on that warranty. The warranty's purpose is to place on a bank taking an instrument from a person making an unauthorized endorsement the responsibility of collecting from that person. The warranty exists even if a cashier's check is involved. Vectra Bank of Englewood v. Bank Western, 890 P.2d 259 (Colo. App. 1995) (decided under former law).

However, a transfer warranty as to the genuineness of the drawer's signature does not apply for the benefit of the drawee bank. Decibel Credit Union v. Pueblo Bank & Trust Co., 996 P.2d 784 (Colo. App. 2000).

Attorney fees are not "damages" and, therefore, are not within the contemplation of subsection (3) under former law. Vectra Bank of Englewood v. Bank Western, 890 P.2d 259 (Colo. App. 1995) (decided under former law).

4-4-208. Presentment warranties. (a) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:

(1) The warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(2) The draft has not been altered;

(3) The warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized; and

(4) If the draft is a demand draft, creation of the demand draft according to the terms on its face was authorized by the person identified as drawer. Nothing in this section shall be construed to impair the rights of the drawer against the drawee.

(b) A drawee making payment may recover from a warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection (b) is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft (i) breach of warranty is a defense to the obligation of the acceptor, and (ii) if the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from a warrantor for breach of warranty the amounts stated in this subsection (b).

(c) If a drawee asserts a claim for breach of warranty under subsection (a) of this section based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by reproving that the indorsement is effective under section 4-3-404 or 4-3-405 or the drawer is precluded under section 4-3-406 or 4-4-406 from asserting against the drawee the unauthorized indorsement or alteration.

(d) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other item is presented for payment to a party obliged to pay the item, and the item is paid, the person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a person entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item. The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(e) The warranties stated in subsections (a) and (b) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within thirty days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(f) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(g) A demand draft is a check, as provided in section 4-3-104 (f).

(h) If the warranty in paragraph (4) of subsection (a) of this section is not given by a transferor under applicable conflict of law rules, then the warranty is not given to that transferor when that transferor is a transferee.

Source: L. 94: Entire article amended with relocations, p. 889, § 2, effective January 1, 1995. **L. 2001:** (a) amended and (g) and (h) added, p. 869, § 7, effective August 8.

Cross references: For the legislative declaration contained in the 2001 act amending subsection (a) and enacting subsections (g) and (h), see section 1 of chapter 244, Session Laws of Colorado 2001.

OFFICIAL COMMENT

This section conforms to Section 3-417 and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3-417. "Draft" is defined in Section 4-104 as including an item that is an order to pay so as to make clear that the term "draft" in Article 4 may include items that are not instruments within Section 3-104.

ANNOTATION

Warranty under (a)(1) of this section is only a warranty that there are no unauthorized or missing endorsements on the check, not that the drawer's signature is genuine. Where there was also no alteration to the checks and no claim that the presenting bank had actual knowledge of the forged drawer's signatures, the presenting bank did not extend any presentment warranty to the drawee bank by returning the checks through the federal reserve system. Decibel Credit Union v. Pueblo Bank & Trust Co., 996 P.2d 784 (Colo. App. 2000).

4-4-209. Encoding and retention warranties. (a) A person who encodes information on or with respect to an item after issue warrants to any subsequent collecting bank and to the payor bank or other payor that the information is correctly encoded. If the customer of a depositary bank encodes, that bank also makes the warranty.

(b) A person who undertakes to retain an item pursuant to an agreement for electronic presentment warrants to any subsequent collecting bank and to the payor bank or other payor that retention and presentment of the item comply with the agreement. If a customer of a depositary bank undertakes to retain an item, that bank also makes this warranty.

(c) A person to whom warranties are made under this section and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, plus expenses and loss of interest incurred as a result of the breach.

Source: L. 94: Entire article amended with relocations, p. 891, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. Encoding and retention warranties are included in Article 4 because they are unique to the bank collection process. These warranties are breached only by the person doing the encoding or retaining the item and not by subsequent banks handling the item. Encoding and check retention may be done by customers who are payees of a large volume of checks; hence, this section imposes warranties on customers as well as banks. If a customer encodes or retains, the depositary bank is also liable for any breach of this warranty.

2. A misencoding of the amount on the MICR line is not an alteration under Section 3-407(a) which defines alteration as changing the contract of the parties. If a drawer wrote a check for $2,500 and the depositary bank encoded $25,000 on the MICR line, the payor bank could debit the drawer's account for only $2,500. This subsection would allow the payor bank to hold the depositary bank liable for the amount paid out over $2,500 without first pursuing the person who received payment. Intervening collecting banks would not be liable to the payor bank for the depositary bank's error. If a drawer wrote a check for $25,000 and the depositary bank encoded $2,500, the payor bank becomes liable for the full amount of the check. The payor bank's rights against the depositary bank depend on whether the payor bank has suffered a loss. Since the payor bank can debit the drawer's account for $25,000, the payor bank has a loss only to the extent that the drawer's account is less than the full amount of the check. There is no requirement that the payor bank pursue collection against the drawer beyond the amount in the drawer's account as a condition to the payor bank's action against the depositary bank for

breach of warranty. See **Georgia Railroad Bank & Trust Co. v. First National Bank & Trust,** 229 S.E.2d 482 (Ga. App. 1976), aff'd, 235 S.E.2d 1 (Ga. 1977), and **First National Bank of Boston v. Fidelity Bank, National Association,** 724 F.Supp. 1168 (E.D. Pa. 1989).

3. A person retaining items under an electronic presentment agreement (Section 4-110) warrants that it has complied with the terms of the agreement regarding its possession of the item and its sending a proper presentment notice. If the keeper is a customer, its depositary bank also makes this warranty.

4-4-210. Security interest of collecting bank in items, accompanying documents, and proceeds. (a) A collecting bank has a security interest in an item and any accompanying documents or the proceeds of either:

(1) In case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied;

(2) In case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given, whether or not the credit is drawn upon or there is a right of charge-back; or

(3) If it makes an advance on or against the item.

(b) If credit given for several items received at one time or pursuant to a single agreement is withdrawn or applied in part, the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

(c) Receipt by a collecting bank of a final settlement for an item is a realization on its security interest in the item, accompanying documents, and proceeds. So long as the bank does not receive final settlement for the item or give up possession of the item or possession or control of the accompanying documents for purposes other than collection, the security interest continues to that extent and is subject to article 9 of this title, but:

(1) No security agreement is necessary to make the security interest enforceable (section 4-9-203 (b) (3) (A));

(2) No filing is required to perfect the security interest; and

(3) The security interest has priority over conflicting perfected security interests in the item, accompanying documents, or proceeds.

Source: L. 94: Entire article amended with relocations, p. 891, § 2, effective January 1, 1995. **L. 2001:** (c)(1) amended, p. 1441, § 27, effective July 1. **L. 2006:** IP(c) amended, p. 497, § 27, effective September 1.

Editor's note: This section is similar to former § 4-4-208 as it existed prior to 1994, and the former § 4-4-210 was relocated to § 4-4-212.

OFFICIAL COMMENT

1. Subsection (a) states a rational rule for the interest of a bank in an item. The customer of the depositary bank is normally the owner of the item and the several collecting banks are agents of the customer (Section 4-201). A collecting agent may properly make advances on the security of paper held for collection, and acquires at common law a possessory lien for these advances. Subsection (a) applies an analogous principle to a bank in the collection chain which extends credit on items in the course of collection. The bank has a security interest to the extent stated in this section. To the extent of its security interest it is a holder for value (Sections 3-303, 4-211) and a holder in due course if it satisfies the other requirements for that status (Section 3-302). Subsection (a) does not derogate from the banker's general common law lien or right of setoff against indebtedness owing in deposit accounts. See Section 1-103. Rather subsection (a) specifically implements and extends the principle as a part of the bank collection process.

2. Subsection (b) spreads the security interest of the bank over all items in a single deposit or received under a single agreement and a single giving of credit. It also adopts the "first-in, first-out" rule.

3. Collection statistics establish that the vast majority of items handled for collection are in fact collected. The first sentence of subsection (c) reflects the fact that in the normal case the bank's security interest is self-liquidating. The remainder of the subsection correlates the secu-

rity interest with the provisions of Article 9, particularly for use in the cases of noncollection in which the security interest may be important.

4-4-211. When bank gives value for purposes of holder in due course. For purposes of determining its status as a holder in due course, a bank has given value to the extent it has a security interest in an item, if the bank otherwise complies with the requirements of section 4-3-302 on what constitutes a holder in due course.

Source: L. 94: Entire article amended with relocations, p. 892, § 2, effective January 1, 1995.

Editor's note: This section is similar to former § 4-4-209 as it existed prior to 1994, and the former § 4-4-211 was relocated to § 4-4-213.

OFFICIAL COMMENT

The section completes the thought of the previous section and makes clear that a security interest in an item is "value" for the purpose of determining the holder's status as a holder in due course. The provision is in accord with the prior law (N.I.L. Section 27) and with Article 3 (Section 3-303). The section does not prescribe a security interest under Section 4-210 as a test of "value" generally because the meaning of "value" under other Articles is adequately defined in Section 1-201.

4-4-212. Presentment by notice of item not payable by, through, or at a bank - liability of drawer or indorser. (a) Unless otherwise instructed, a collecting bank may present an item not payable by, through, or at a bank by sending to the party to accept or pay a written notice that the bank holds the item for acceptance or payment. The notice must be sent in time to be received on or before the day when presentment is due and the bank must meet any requirement of the party to accept or pay under section 4-3-501 by the close of the bank's next banking day after it knows of the requirement.

(b) If presentment is made by notice and payment, acceptance, or request for compliance with a requirement under section 4-3-501 is not received by the close of business on the day after maturity or, in the case of demand items, by the close of business on the third banking day after notice was sent, the presenting bank may treat the item as dishonored and charge any drawer or indorser by sending it notice of the facts.

Source: L. 94: Entire article amended with relocations, p. 892, § 2, effective January 1, 1995.

Editor's note: This section is similar to former § 4-4-210 as it existed prior to 1994, and the former § 4-4-212 was relocated to § 4-4-214.

OFFICIAL COMMENT

1. This section codifies a practice extensively followed in presentation of trade acceptances and documentary and other drafts drawn on nonbank payors. It imposes a duty on the payor to respond to the notice of the item if the item is not to be considered dishonored. Notice of such a dishonor charges drawers and indorsers. Presentment under this section is good presentment under Article 3. See Section 3-501.

2. A drawee not receiving notice is not, of course, liable to the drawer for wrongful dishonor.

3. A bank so presenting an instrument must be sufficiently close to the drawee to be able to exhibit the instrument on the day it is requested to do so or the next business day at the latest.

4-4-213. Medium and time of settlement by bank. (a) With respect to settlement by a bank, the medium and time of settlement may be prescribed by federal reserve regulations

or circulars, clearing-house rules, and the like, or agreement. In the absence of such prescription:

(1) The medium of settlement is cash or credit to an account in a federal reserve bank of or specified by the person to receive settlement; and

(2) The time of settlement is:

(i) With respect to tender of settlement by cash, a cashier's check, or teller's check, when the cash or check is sent or delivered;

(ii) With respect to tender of settlement by credit in an account in a federal reserve bank, when the credit is made;

(iii) With respect to tender of settlement by a credit or debit to an account in a bank, when the credit or debit is made or, in the case of tender of settlement by authority to charge an account, when the authority is sent or delivered; or

(iv) With respect to tender of settlement by a funds transfer, when payment is made pursuant to section 4-4.5-406 (a) to the person receiving settlement.

(b) If the tender of settlement is not by a medium authorized by subsection (a) of this section or the time of settlement is not fixed by subsection (a) of this section, no settlement occurs until the tender of settlement is accepted by the person receiving settlement.

(c) If settlement for an item is made by cashier's check or teller's check and the person receiving settlement, before its midnight deadline:

(1) Presents or forwards the check for collection, settlement is final when the check is finally paid; or

(2) Fails to present or forward the check for collection, settlement is final at the midnight deadline of the person receiving settlement.

(d) If settlement for an item is made by giving authority to charge the account of the bank giving settlement in the bank receiving settlement, settlement is final when the charge is made by the bank receiving settlement if there are funds available in the account for the amount of the item.

Source: L. 94: Entire article amended with relocations, p. 892, § 2, effective January 1, 1995.

Editor's note: This section is similar to former § 4-4-211 as it existed prior to 1994, and the former § 4-4-213 was relocated to § 4-4-215.

OFFICIAL COMMENT

1. Subsection (a) sets forth the medium of settlement that the person receiving settlement must accept. In nearly all cases the medium of settlement will be determined by agreement or by Federal Reserve regulations and circulars, clearing-house rules, and the like. In the absence of regulations, rules or agreement, the person receiving settlement may demand cash or credit in a Federal Reserve bank. If the person receiving settlement does not have an account in a Federal Reserve bank, it may specify the account of another bank in a Federal Reserve bank. In the unusual case in which there is no agreement on the medium of settlement and the bank making settlement tenders settlement other than cash or Federal Reserve bank credit, no settlement has occurred under subsection (b) unless the person receiving settlement accepts the settlement tendered. For example, if a payor bank, without agreement, tenders a teller's check, the bank receiving the settlement may reject the check and return it to the payor bank or it may accept the check as settlement.

2. In several provisions of Article 4 the time that a settlement occurs is relevant. Subsection (a) sets out a general rule that the time of settlement, like the means of settlement, may be prescribed by agreement. In the absence of agreement, the time of settlement for tender of the common agreed media of settlement is that set out in subsection (a)(2). The time of settlement by cash, cashier's or teller's check or authority to charge an account is the time the cash, check or authority is sent, unless presentment is over the counter in which case settlement occurs upon delivery to the presenter. If there is no agreement on the time of settlement and the tender of settlement is not made by one of the media set out in subsection (a), under subsection (b) the time of settlement is the time the settlement is accepted by the person receiving settlement.

3. Subsections (c) and (d) are special provisions for settlement by remittance drafts and authority to charge an account in the bank receiving settlement. The relationship between fi-

nal settlement and final payment under Section 4-215 is addressed in subsection (b) of Section 4-215. With respect to settlement by cashier's checks or teller's checks, other than in response to over-the-counter presentment, the bank receiving settlement can keep the risk that the check will not be paid on the bank tendering the check in settlement by acting to initiate collection of the check within the midnight deadline of the bank receiving settlement. If the bank fails to initiate settlement before its midnight deadline, final settlement occurs at the midnight deadline, and the bank receiving settlement assumes the risk that the check will not be paid. If there is no agreement that permits the bank tendering settlement to tender a cashier's or teller's check, subsection (b) allows the bank receiving the check to reject it, and, if it does, no settlement occurs. However, if the bank accepts the check, settlement occurs and the time of final settlement is governed by subsection (c).

With respect to settlement by tender of authority to charge the account of the bank making settlement in the bank receiving settlement, subsection (d) provides that final settlement does not take place until the account charged has available funds to cover the amount of the item. If there is no agreement that permits the bank tendering settlement to tender an authority to charge an account as settlement, subsection (b) allows the bank receiving the tender to reject it. However, if the bank accepts the authority, settlement occurs and the time of final settlement is governed by subsection (d).

4-4-214. Right of charge-back or refund - liability of collecting bank - return of item. (a) If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor, suspension of payments by a bank, or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge-back the amount of any credit given for the item to its customer's account, or obtain refund from its customer, whether or not it is able to return the item, if, by its midnight deadline or within a longer reasonable time after it learns the facts, it returns the item or sends notification of the facts. If the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain refund from its customer, but it is liable for any loss resulting from the delay. These rights to revoke, charge back, and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final.

(b) A collecting bank returns an item when it is sent or delivered to the bank's customer or transferor or pursuant to its instructions.

(c) A depositary bank that is also the payor may charge back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books (section 4-4-301).

(d) The right to charge back is not affected by:

(1) Previous use of a credit given for the item; or

(2) Failure by any bank to exercise ordinary care with respect to the item, but a bank so failing remains liable.

(e) A failure to charge back or claim refund does not affect other rights of the bank against the customer or any other party.

(f) If credit is given in dollars as the equivalent of the value of an item payable in a foreign money, the dollar amount of any charge-back or refund must be calculated on the basis of the bank-offered spot rate for the foreign money prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course.

Source: L. 94: Entire article amended with relocations, p. 894, § 2, effective January 1, 1995.

Editor's note: This section is similar to former § 4-4-212 as it existed prior to 1994, and the former § 4-4-214 was relocated to § 4-4-216.

OFFICIAL COMMENT

1. Under current bank practice, in a major portion of cases banks make provisional settlement for items when they are first received and then await subsequent determination of whether

the item will be finally paid. This is the principal characteristic of what are referred to in banking parlance as "cash items." Statistically, this practice of settling provisionally first and then awaiting final payment is justified because the vast majority of such cash items are finally paid, with the result that in this great preponderance of cases it becomes unnecessary for the banks making the provisional settlements to make any further entries. In due course the provisional settlements become final simply with the lapse of time. However, in those cases in which the item being collected is not finally paid or if for various reasons the bank making the provisional settlement does not itself receive final payment, provision is made in subsection (a) for the reversal of the provisional settlements, charge-back of provisional credits and the right to obtain refund.

2. Various causes of a bank's not receiving final payment, with the resulting right of charge-back or refund, are stated or suggested in subsection (a). These include dishonor of the original item; dishonor of a remittance instrument given for it; reversal of a provisional credit for the item; suspension of payments by another bank. The causes stated are illustrative; the right of charge-back or refund is stated to exist whether the failure to receive final payment in ordinary course arises through one of them "or otherwise."

3. The right of charge-back or refund exists if a collecting bank has made a provisional settlement for an item with its customer but terminates if and when a settlement received by the bank for the item is or becomes final. If the bank fails to receive such a final settlement the right of charge-back or refund must be exercised promptly after the bank learns the facts. The right exists (if so promptly exercised) whether or not the bank is able to return the item. The second sentence of subsection (a) adopts the view of **Appliance Buyers Credit Corp. v. Prospect National Bank,** 708 F.2d 290 (7th Cir. 1983), that if the midnight deadline for returning an item or giving notice is not met, a collecting bank loses its rights only to the extent of damages for any loss resulting from the delay.

4. Subsection (b) states when an item is returned by a collecting bank. Regulation CC, Section 229.31 preempts this subsection with respect to checks by allowing direct return to the depositary bank. Because a returned check may follow a different path than in forward collection, settlement given for the check is final and not provisional except as between the depositary bank and its customer. Regulation CC Section 229.36(d). See also Regulations CC Sections 229.31(c) and 229.32(b). Thus owing to the federal preemption, this subsection applies only to noncheck items.

5. The rule of subsection (d) relating to charge-back (as distinguished from claim for refund) applies irrespective of the cause of the nonpayment, and of the person ultimately liable for nonpayment. Thus charge-back is permitted even if nonpayment results from the depositary bank's own negligence. Any other rule would result in litigation based upon a claim for wrongful dishonor of other checks of the customer, with potential damages far in excess of the amount of the item. Any other rule would require a bank to determine difficult questions of fact. The customer's protection is found in the general obligation of good faith (Sections 1-203 and 4-103). If bad faith is established the customer's recovery "includes other damages, if any, suffered by the party as a proximate consequence" (Section 4-103(e); see also Section 4-402).

6. It is clear that the charge-back does not relieve the bank from any liability for failure to exercise ordinary care in handling the item. The measure of damages for such failure is stated in Section 4-103(e).

7. Subsection (f) states a rule fixing the time for determining the rate of exchange if there is a charge-back or refund of a credit given in dollars for an item payable in a foreign currency. Compare Section 3-107. Fixing such a rule is desirable to avoid disputes. If in any case the parties wish to fix a different time for determining the rate of exchange, they may do so by agreement.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Liability of indorser where estoppel created. While the principle that an indorser is liable on his warranty is correctly stated, the rule has no application when an estoppel has been created which would preclude plaintiff from obtaining a refund of the amount paid to defendant. First Nat'l Bank v. Ulibarri, 38 Colo. App. 428, 557 P.2d 1221 (1976).

Where payor bank retains a demand item beyond its midnight deadline without settling it, nothing occurs to cause the provisional settlement between depositor and depositary bank to become final, and the depositary bank still has a right of refund from the depositor. Mercantile Bank & Trust Co. v. Hunter, 31 Colo. App. 200, 501 P.2d 486 (1972).

When a depositary bank has made a provisional settlement for an item for its depositor but fails to receive final settlement from the payor bank, the depositary bank may revoke the provisional settlement and obtain a refund from the depositor. Mercantile Bank & Trust Co. v. Hunter, 31 Colo. App. 200, 501 P.2d 486 (1972).

The bank's failure to make a formal protest is immaterial where one's liability is based not on his indorsement of a check, but on his status as depositor and withdrawer of funds. Mercantile Bank & Trust Co. v. Hunter, 31 Colo. App. 200, 501 P.2d 486 (1972).

4-4-215. Final payment of item by payor bank - when provisional debits and credits become final - when certain credits become available for withdrawal. (a) An item is finally paid by a payor bank when the bank has first done any of the following:

(1) Paid the item in cash;

(2) Settled for the item without having a right to revoke the settlement under statute, clearing-house rule, or agreement; or

(3) Made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing-house rule, or agreement.

(b) If provisional settlement for an item does not become final, the item is not finally paid.

(c) If provisional settlement for an item between the presenting and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the item by the payor bank.

(d) If a collecting bank receives a settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.

(e) Subject to (i) applicable law stating a time for availability of funds and (ii) any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in a customer's account becomes available for withdrawal as of right:

(1) If the bank has received a provisional settlement for the item, when the settlement becomes final and the bank has had a reasonable time to receive return of the item and the item has not been received within that time;

(2) If the bank is both the depositary bank and the payor bank, and the item is finally paid, at the opening of the bank's second banking day following receipt of the item.

(f) Subject to any applicable law stating a time for availability of funds and any right of a bank to apply a deposit to an obligation of the depositor, a deposit of money becomes available for withdrawal as of right at the opening of the bank's next banking day after receipt of the deposit.

Source: L. 94: Entire article amended with relocations, p. 895, § 2, effective January 1, 1995.

Editor's note: This section is similar to former § 4-4-213 as it existed prior to 1994.

OFFICIAL COMMENT

1. By the definition and use of the term "settle" (Section 4-104(a)(11)) this Article recognizes that various debits or credits, remittances, settlements or payments given for an item may be either provisional or final, that settlements sometimes are provisional and sometimes are final and sometimes are provisional for awhile but later become final. Subsection (a) defines when settlement for an item constitutes final payment.

Final payment of an item is important for a number of reasons. It is one of several factors determining the relative priorities between items and notices, stop-payment orders, legal process and setoffs (Section 4-303). It is the "end of the line" in the collection process and the "turn around" point commencing the return flow of proceeds. It is the point at which many provisional settlements become final. See Section 4-215(c). Final payment of an item by the payor bank fixes preferential rights under Section 4-216.

2. If an item being collected moves through several states, e.g., is deposited for collection in California, moves through two or three California banks to the Federal Reserve Bank of San Francisco, to the Federal Reserve Bank of Boston, to a payor bank in Maine, the collection process involves the eastward journey of the item from California to Maine and the westward journey of the proceeds from Maine to California. Subsection (a) recognizes that final payment does not take place, in this hypothetical case, on the journey of the item eastward. It also adopts

the view that neither does final payment occur on the journey westward because what in fact is journeying westward are *proceeds* of the item.

3. Traditionally and under various decisions payment in cash of an item by a payor bank has been considered final payment. Subsection (a)(1) recognizes and provides that payment of an item in cash by a payor bank is final payment.

4. Section 4-104(a)(11) defines "settle" as meaning "to pay in cash, by clearing-house settlement, in a charge or credit or by remittance, or otherwise as agreed. A settlement may be either provisional or final." Subsection (a)(2) of Section 4-215 provides that an item is finally paid by a payor bank when the bank has "settled for the item without having a right to revoke the settlement under statute, clearing-house rule or agreement." Former subsection (1)(b) is modified by subsection (a)(2) to make clear that a payor bank cannot make settlement provisional by unilaterally reserving a right to revoke the settlement. The right must come from a statute (e.g., Section 4-301), clearing-house rule or other agreement. Subsection (a)(2) provides in effect that if the payor bank finally settles for an item this constitutes final payment of the item. The subsection operates if nothing has occurred and no situation exists making the settlement provisional. If under statute, clearing-house rule or agreement, a right of revocation of the settlement exists, the settlement is provisional. Conversely, if there is an absence of a right to revoke under statute, clearing-house rule or agreement, the settlement is final and such final settlement constitutes final payment of the item.

A primary example of a statutory right on the part of the payor bank to revoke a settlement is the right to revoke conferred by Section 4-301. The underlying theory and reason for deferred posting statutes (Section 4-301) is to require a settlement on the date of receipt of an item but to keep that settlement provisional with the right to revoke prior to the midnight deadline. In any case in which Section 4-301 is applicable, any settlement by the payor bank is provisional solely by virtue of the statute, subsection (a)(2) of Section 4-215 does not operate, and such provisional settlement does not constitute final payment of the item. With respect to checks, Regulation CC Section 229.36(d) provides that settlement between banks for the forward collection of checks is final. The relationship of this provision to Article 4 is discussed in the Commentary to that section.

A second important example of a right to revoke a settlement is that arising under clearing-house rules. It is very common for clearing-house rules to provide that items exchanged and settled for in a clearing (e.g., before 10:00 a.m. on Monday) may be returned and the settlements revoked up to but not later than 2:00 p.m. on the same day (Monday) or under deferred posting at some hour on the next business day (e.g., 2:00 p.m. Tuesday). Under this type of rule the Monday morning settlement is provisional and being provisional does not constitute a final payment of the item.

An example of an agreement allowing the payor bank to revoke a settlement is a case in which the payor bank is also the depositary bank and has signed a receipt or duplicate deposit ticket or has made an entry in a passbook acknowledging receipt, for credit to the account of A, of a check drawn on it by B. If the receipt, deposit ticket, passbook or other agreement with A is to the effect that any credit so entered is provisional and may be revoked pending the time required by the payor bank to process the item to determine if it is in good form and there are funds to cover it, the agreement keeps the receipt or credit provisional and avoids its being either final settlement or final payment.

The most important application of subsection (a)(2) is that in which presentment of an item has been made over the counter for immediate payment. In this case Section 4-301(a) does not apply to make the settlement provisional, and final payment has occurred unless a rule or agreement provides otherwise.

5. Former Section 4-213(1)(c) provided that final payment occurred when the payor bank completed the "process of posting." The term was defined in former Section 4-109. In the present Article, Section 4-109 has been deleted and the process-of-posting test has been abandoned in Section 4-215(a) for determining when final payment is made. Difficulties in determining when the events described in former Section 4-109 take place make the process-of-posting test unsuitable for a system of automated check collection or electronic presentment.

6. The last sentence of former Section 4-213(1) is deleted as an unnecessary source of confusion. Initially the view that payor bank may be accountable for, that is, liable for the amount of, an item that it has already paid seems incongruous. This is particularly true in the light of the language formerly found in Section 4-302 stating that the payor bank can defend against liability for accountability by showing that it has already settled for the item. But, at least with respect to former Section 4-213(1)(c), such a provision was needed because under the process-of-posting test a payor bank may have paid an item without settling for it. Now that Article 4 has abandoned the process-of-posting test, the sentence is no longer needed. If the payor bank has neither paid the item nor returned it within its midnight deadline, the payor bank is accountable under Section 4-302.

7. Subsection (a)(3) covers the situation in which the payor bank makes a provisional settlement for an item, and this settlement becomes final at a later time by reason of the failure of the payor bank to revoke it in the time and manner permitted by statute, clearing-house rule or

agreement. An example of this type of situation is the clearing-house settlement referred to in Comment 4. In the illustration there given if the time limit for the return of items received in the Monday morning clearing is 2:00 p.m. on Tuesday and the provisional settlement has not been revoked at that time in a manner permitted by the clearing-house rules, the provisional settlement made on Monday morning becomes final at 2:00 p.m. on Tuesday. Subsection (a)(3) provides specifically that in this situation the item is finally paid at 2:00 p.m. Tuesday. If on the other hand a payor bank receives an item in the mail on Monday and makes some provisional settlement for the item on Monday, it has until midnight on Tuesday to return the item or give notice and revoke any settlement under Section 4-301. In this situation subsection (a)(3) of Section 4-215 provides that if the provisional settlement made on Monday is not revoked before midnight on Tuesday as permitted by Section 4-301, the item is finally paid at midnight on Tuesday. With respect to checks, Regulation CC Section 229.30 (c) allows an extension of the midnight deadline under certain circumstances. If a bank does not expeditiously return a check liability may accrue under Regulation CC Section 229.38. For the relationship of that liability to responsibility under this Article, see Regulation CC Sections 229.30 and 229.38.

8. Subsection (b) relates final settlement to final payment under Section 4-215. For example, if a payor bank makes provisional settlement for an item by sending a cashier's or teller's check and that settlement fails to become final under Section 4-213(c), subsection (b) provides that final payment has not occurred. If the item is not paid, the drawer remains liable, and under Section 4-302(a) the payor bank is accountable unless it has returned the item before its midnight deadline. In this regard, subsection (b) is an exception to subsection (a)(3). Even if the payor bank has not returned an item by its midnight deadline there is still no final payment if provisional settlement had been made and settlement failed to become final. However, if presentment of the item was over the counter for immediate payment, final payment has occurred under Section 4-215(a)(2). Subsection (b) does not apply because the settlement was not provisional. Section 4-301(a). In this case the presenting person, often the payee of the item, has the right to demand cash or the cash equivalent of federal reserve credit. If the presenting person accepts another medium of settlement such as a cashier's or teller's check, the presenting person takes the risk that the payor bank may fail to pay a cashier's check because of insolvency or that the drawee of a teller's check may dishonor it.

9. Subsection (c) states the country-wide usage that when the item is finally paid by the payor bank under subsection (a) this final payment automatically without further action "firms up" other provisional settlements made for it. However, the subsection makes clear that this "firming up" occurs only if the settlement between the presenting and payor banks was made either through a clearing house or by debits and credits in accounts between them. It does not take place if the payor bank remits for the item by sending some form of remittance instrument. Further, the "firming up" continues only to the extent that provisional debits and credits are entered seriatim in accounts between banks which are successive to the presenting bank. The automatic "firming up" is broken at any time that any collecting bank remits for the item by sending a remittance draft, because final payment to the remittee then usually depends upon final payment of the remittance draft.

10. Subsection (d) states the general rule that if a collecting bank receives settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item. One means of accounting is to remit to its customer the amount it has received on the item. If previously it gave to its customer a provisional credit for the item in an account its receipt of final settlement for the item "firms up" this provisional credit and makes it final. When this credit given by it so becomes final, in the usual case its agency status terminates and it becomes a debtor to its customer for the amount of the item. See Section 4-201(a). If the accounting is by a remittance instrument or authorization to charge further time will usually be required to complete its accounting (Section 4-213).

11. Subsection (e) states when certain credits given by a bank to its customer become available for withdrawal as of right. Subsection (e)(1) deals with the situation in which a bank has given a credit (usually provisional) for an item to its customer and in turn has received a provisional settlement for the item from an intermediary or payor bank to which it has forwarded the item. In this situation before the provisional credit entered by the collecting bank in the account of its customer becomes available for withdrawal as of right, it is not only necessary that the provisional settlement received by the bank for the item becomes final but also that the collecting bank has a reasonable time to receive return of the item and the item has not been received within that time. How much time is "reasonable" for these purposes will of course depend on the distance the item has to travel and the number of banks through which it must pass (having in mind not only travel time by regular lines of transmission but also the successive midnight deadlines of the several banks) and other pertinent facts. Also, if the provisional settlement received is some form of a remittance instrument or authorization to charge, the "reasonable" time depends on the identity and location of the payor of the remittance instrument,

the means for clearing such instrument, and other pertinent facts. With respect to checks Regulation CC Sections 229.10-229.13 or similar applicable state law (Section 229.20) control. This is also time for the situation described in Comment 12.

12. Subsection (e)(2) deals with the situation of a bank that is both a depositary bank and a payor bank. The subsection recognizes that if A and B are both customers of a depositary-payor bank and A deposits B's check on the depositary-payor in A's account on Monday, time must be allowed to permit the check under the deferred posting rules of Section 4-301 to reach the bookkeeper for B's account at some time on Tuesday, and, if there are insufficient funds in B's account, to reverse or charge back the provisional credit in A's account. Consequently this provisional credit in A's account does not become available for withdrawal as of right until the opening of business on Wednesday. If it is determined on Tuesday that there are insufficient funds in B's account to pay the check, the credit to A's account can be reversed on Tuesday. On the other hand if the item is in fact paid on Tuesday, the rule of subsection (e)(2) is desirable to avoid uncertainty and possible disputes between the bank and its customer as to exactly what hour within the day the credit is available.

ANNOTATION

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974). For article, "Setoff and Security Interests In Deposit Accounts", see 17 Colo. Law. 2107 (1988).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

The rule that a payor bank is "accountable" for an item does not mean that there has been a final settlement which would preclude a depositary bank from charging the amount of the item back to its depositor, for this section sets forth the circumstances under which a provisional settlement becomes final, and there is no provision that mere accountability of a payor bank for a check is a final settlement unless the check is actually paid by the payor bank. Mercantile Bank & Trust Co. v. Hunter, 31 Colo. App. 200, 501 P.2d 486 (1972).

Hence, where payor bank retains a demand item beyond its midnight deadline without settling it, nothing occurs to cause the provisional settlement between depositor and depositary bank to become final, and the depositary bank still has a right of refund from the depositor. Mercantile Bank & Trust Co. v. Hunter, 31 Colo. App. 200, 501 P.2d 486 (1972).

Final settlement of a demand item occurs when an item is deemed "finally paid" as a result of payor's bank failure to revoke a provisional settlement before the midnight deadline. Kimberly A. Allen Trust v. FirstBank of Lakewood, 989 P.2d 203 (Colo. App. 1999) (disagreeing with Mercantile Bank & Trust Co. v. Hunter cited above).

Section and comments, when read together with § 4-3-418 and comments, treat a cashier's check as the equivalent of cash and preclude issuing banks from dishonoring them at any time. Flatiron Linen, Inc. v. First Amer. State Bank, 23 P.3d 1209 (Colo. 2001).

Cashier's checks represent the unconditional obligation of the issuing bank to pay, and therefore, banks may not dishonor their cashier's checks once issued. Flatiron Linen, Inc. v. First Amer. State Bank, 23 P.3d 1209 (Colo. 2001).

4-4-216. Insolvency and preference. (a) If an item is in or comes into the possession of a payor or collecting bank that suspends payment and the item has not been finally paid, the item must be returned by the receiver, trustee, or agent in charge of the closed bank to the presenting bank or the closed bank's customer.

(b) If a payor bank finally pays an item and suspends payments without making a settlement for the item with its customer or the presenting bank which settlement is or becomes final, the owner of the item has a preferred claim against the payor bank.

(c) If a payor bank gives or a collecting bank gives or receives a provisional settlement for an item and thereafter suspends payments, the suspension does not prevent or interfere with the settlement's becoming final if the finality occurs automatically upon the lapse of certain time or the happening of certain events.

(d) If a collecting bank receives from subsequent parties settlement for an item, which settlement is or becomes final and the bank suspends payments without making a settlement for the item with its customer which settlement is or becomes final, the owner of the item has a preferred claim against the collecting bank.

Source: L. 94: Entire article amended with relocations, p. 896, § 2, effective January 1, 1995.

Editor's note: This section is similar to former § 4-4-214 as it existed prior to 1994.

OFFICIAL COMMENT

1. The underlying purpose of the provisions of this section is not to confer upon banks, holders of items or anyone else preferential positions in the event of bank failures over general depositors or any other creditors of the failed banks. The purpose is to fix as definitely as possible the cut-off point of time for the completion or cessation of the collection process in the case of items that happen to be in the process at the time a particular bank suspends payments. It must be remembered that in bank collections as a whole and in the handling of items by an individual bank, items go through a whole series of processes. It must also be remembered that at any particular point of time a particular bank (at least one of any size) is functioning as a depositary bank for some items, as an intermediary bank for others, as a presenting bank for still others and as a payor bank for still others, and that when it suspends payments it will have close to its normal load of items working through its various processes. For the convenience of receivers, owners of items, banks, and in fact substantially everyone concerned, it is recognized that at the particular moment of time that a bank suspends payment, a certain portion of the items being handled by it have progressed far enough in the bank collection process that it is preferable to permit them to continue the remaining distance, rather than to send them back and reverse the many entries that have been made or the steps that have been taken with respect to them. Therefore, having this background and these purposes in mind, the section states what items must be turned backward at the moment suspension intervenes and what items have progressed far enough that the collection process with respect to them continues, with the resulting necessary statement of rights of various parties flowing from this prescription of the cut-off time.

2. The rules stated are similar to those stated in the American Bankers Association Bank Collection Code, but with the abandonment of any theory of trust. On the other hand, some law previous to this Act may be relevant. See Note, Uniform Commercial Code: Stopping Payment of an Item Deposited with an Insolvent Depositary Bank, 40 Okla. L. Rev. 689 (1987). Although for practical purposes Federal Deposit Insurance affects materially the result of bank failures on holders of items and banks, no attempt is made to vary the rules of the section by reason of such insurance.

3. It is recognized that in view of **Jennings v. United States Fidelity & Guaranty Co.**, 294 U.S. 216, 55 S.Ct. 394, 79 L.Ed. 869, 99 A.L.R. 1248 (1935), amendment of the National Bank Act would be necessary to have this section apply to national banks. But there is no reason why it should not apply to others. See Section 1-108.

ANNOTATION

Law reviews. For article, "Commercial Law", which discusses recent Tenth Circuit decisions dealing with questions of commercial law, see 63 Den. U.L. Rev. 225 (1986).

PART 3

COLLECTION OF ITEMS - PAYOR BANKS

4-4-301. Deferred posting - recovery of payment by return of items - time of dishonor - return of items by payor bank. (a) If a payor bank settles for a demand item other than a documentary draft presented otherwise than for immediate payment over the counter before midnight of the banking day of receipt, the payor bank may revoke the settlement and recover the settlement if, before it has made final payment and before its midnight deadline, it:

(1) Returns the item; or

(2) Sends written notice of dishonor or nonpayment if the item is unavailable for return.

(b) If a demand item is received by a payor bank for credit on its books, it may return the item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in subsection (a) of this section.

(c) Unless previous notice of dishonor has been sent, an item is dishonored at the time when for the purposes of dishonor it is returned or notice sent in accordance with this section.

(d) An item is returned:

(1) As to an item presented through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with clearing-house rules; or

(2) In all other cases, when it is sent or delivered to the bank's customer or transferor or pursuant to instructions.

Source: L. 94: Entire article amended with relocations, p. 897, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. The term "deferred posting" appears in the caption of Section 4-301. This refers to the practice permitted by statute in most of the states before the UCC under which a payor bank receives items on one day but does not post the items to the customer's account until the next day. Items dishonored were then returned after the posting on the day after receipt. Under Section 4-301 the concept of "deferred posting" merely allows a payor bank that has settled for an item on the day of receipt to return a dishonored item on the next day before its midnight deadline, without regard to when the item was actually posted. With respect to checks Regulation CC Section 229.30(c) extends the midnight deadline under the UCC under certain circumstances. See the Commentary to Regulation CC Section 229.38(d) on the relationship between the UCC and Regulation CC on settlement.

2. The function of this section is to provide the circumstances under which a payor bank that has made timely settlement for an item may return the item and revoke the settlement so that it may recover any settlement made. These circumstances are: (1) the item must be a demand item other than a documentary draft; (2) the item must be presented otherwise than for immediate payment over the counter; and (3) the payor bank must return the item (or give notice if the item is unavailable for return) before its midnight deadline and before it has paid the item. With respect to checks, see Regulation CC Section 229.31(f) on notice in lieu of return and Regulation CC Section 229.33 as to the different requirement of notice of nonpayment. An instance of when an item may be unavailable for return arises under a collecting bank check retention plan under which presentment is made by a presentment notice and the item is retained by the collecting bank. Subsection 4-215(a)(2) provides that final payment occurs if the payor bank has settled for an item without a right to revoke the settlement under statute, clearing-house rule or agreement. In any case in which Section 4-301(a) is applicable, the payor bank has a right to revoke the settlement by statute; therefore, Section 4-215(a)(2) is inoperable, and the settlement is provisional. Hence, if the settlement is not over the counter and the payor bank settles in a manner that does not constitute final payment, the payor bank can revoke the settlement by returning the item before its midnight deadline.

3. The relationship of Section 4-301(a) to final settlement and final payment under Section 4-215 is illustrated by the following case. Depositary Bank sends by mail an item to Payor Bank with instructions to settle by remitting a teller's check drawn on a bank in the city where Depositary Bank is located. Payor Bank sends the teller's check on the day the item was presented. Having made timely settlement, under the deferred posting provisions of Section 4-301(a), Payor Bank may revoke that settlement by returning the item before its midnight deadline. If it fails to return the item before its midnight deadline, it has finally paid the item if the bank on which the teller's check was drawn honors the check. But if the teller's check is dishonored there has been no final settlement under Section 4-213(c) and no final payment under Section 4-215(b). Since the Payor Bank has neither paid the item nor made timely return, it is accountable for the item under Section 4-302(a).

4. The time limits for action imposed by subsection (a) are adopted by subsection (b) for cases in which the payor bank is also the depositary bank, but in this case the requirement of a settlement on the day of receipt is omitted.

5. Subsection (c) fixes a base point from which to measure the time within which notice of dishonor must be given. See Section 3-503.

6. Subsection (d) leaves banks free to agree upon the manner of returning items but establishes a precise time when an item is "returned." For definition of "sent" as used in paragraphs (1) and (2) see Section 1-201(38). Obviously the subsection assumes that the item has not been "finally paid" under Section 4-215(a). If it has been, this provision has no operation.

7. The fact that an item has been paid under proposed Section 4-215 does not preclude the

payor bank from asserting rights of restitution or revocation under Section 3-418. **National Savings and Trust Co. v. Park Corp.,** 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S. 939 (1984), is the correct interpretation of the present law on this issue.

4-4-302. Payor bank's responsibility for late return of item. (a) If an item is presented to and received by a payor bank, the bank is accountable for the amount of:

(1) A demand item, other than a documentary draft, whether properly payable or not, if the bank, in any case in which it is not also the depositary bank, retains the item beyond midnight of the banking day of receipt without settling for it or, whether or not it is also the depositary bank, does not pay or return the item or send notice of dishonor until after its midnight deadline; or

(2) Any other properly payable item unless within the time allowed for acceptance or payment of that item, the bank either accepts or pays the item or returns it and accompanying documents.

(b) The liability of a payor bank to pay an item pursuant to subsection (a) of this section is subject to defenses based on breach of a presentment warranty (section 4-4-208) or proof that the person seeking enforcement of the liability presented or transferred the item for the purpose of defrauding the payor bank.

Source: L. 94: Entire article amended with relocations, p. 897, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. Subsection (a)(1) continues the former law distinguishing between cases in which the payor bank is not also the depositary bank and those in which the payor bank is also the depositary bank ("on us" items). For "on us" items the payor bank is accountable if it retains the item beyond its midnight deadline without settling for it. If the payor bank is not the depositary bank it is accountable if it retains the item beyond midnight of the banking day of receipt without settling for it. It may avoid accountability either by settling for the item on the day of receipt and returning the item before its midnight deadline under Section 4-301 or by returning the item on the day of receipt. This rule is consistent with the deferred posting practice authorized by Section 4-301 which allows the payor bank to make provisional settlement for an item on the day of receipt and to revoke that settlement by returning the item on the next day. With respect to checks, Regulation CC Section 229.36(d) provides that settlements between banks for forward collection of checks are final when made. See the Commentary on that provision for its effect on the UCC.

2. If the settlement given by the payor bank does not become final, there has been no payment under Section 4-215(b), and the payor bank giving the failed settlement is accountable under subsection (a)(1) of Section 4-302. For instance, the payor bank makes provisional settlement by sending a teller's check that is dishonored. In such a case settlement is not final under Section 4-213(c) and no payment occurs under Section 4-215(b). Payor bank is accountable on the item. The general principle is that unless settlement provides the presenting bank with usable funds, settlement has failed and the payor bank is accountable for the amount of the item.

3. Subsection (b) is an elaboration of the deleted introductory language of former Section 4-302: "In the absence of a valid defense such as breach of a presentment warranty (subsection (1) of Section 4-207), settlement effected or the like ... ." A payor bank can defend an action against it based on accountability by showing that the item contained a forged indorsement or a fraudulent alteration. Subsection (b) drops the ambiguous "or the like" language and provides that the payor bank may also raise the defense of fraud. Decisions that hold an accountable bank's liability to be "absolute" are rejected. A payor bank that makes a late return of an item should not be liable to a defrauder operating a check kiting scheme. In **Bank of Leumi Trust Co. v. Bally's Park Place Inc.,** 528 F.Supp. 349 (S.D.N.Y. 1981), and **American National Bank v. Foodbasket,** 497 P.2d 546 (Wyo. 1972), banks that were accountable under Section 4-302 for missing their midnight deadline were successful in defending against parties who initiated collection knowing that the check would not be paid. The "settlement effected" language is deleted as unnecessary. If a payor bank is accountable for an item it is liable to pay it. If it has made final payment for an item, it is no longer accountable for the item.

ANNOTATION

Where payor bank retains a demand item beyond its midnight deadline without settling it, nothing occurs to cause the provisional settlement between depositor and depositary bank to become final, and the depositary bank still has a right of refund from the depositor. Mercantile Bank & Trust Co. v. Hunter, 31 Colo. App. 200, 501 P.2d 486 (1972).

Strict compliance with the midnight deadline requirement is mandatory even though bank could have properly refused to pay the debits presented against an account because of account's bankruptcy. Am. Nat. Bank and Trust v. Central Bank, 132 Bankr. 171 (Bankr. D. Colo. 1991).

4-4-303. When items subject to notice, stop-payment order, legal process, or setoff - order in which items may be charged or certified. (a) Any knowledge, notice, or stop-payment order received by, legal process served upon, or setoff exercised by a payor bank comes too late to terminate, suspend, or modify the bank's right or duty to pay an item or to charge its customer's account for the item if the knowledge, notice, stop-payment order, or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the earliest of the following:

(1) The bank accepts or certifies the item;

(2) The bank pays the item in cash;

(3) The bank settles for the item without having a right to revoke the settlement under statute, clearing-house rule, or agreement;

(4) The bank becomes accountable for the amount of the item under section 4-4-302 dealing with the payor bank's responsibility for late return of items; or

(5) With respect to checks, a cutoff hour no earlier than one hour after the opening of the next banking day after the banking day on which the bank received the check and no later than the close of that next banking day or, if no cutoff hour is fixed, the close of the next banking day after the banking day on which the bank received the check.

(b) Subject to subsection (a) of this section, items may be accepted, paid, certified, or charged to the indicated account of its customer in any order.

Source: L. 94: Entire article amended with relocations, p. 898, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. While a payor bank is processing an item presented for payment, it may receive knowledge or a legal notice affecting the item, such as knowledge or a notice that the drawer has filed a petition in bankruptcy or made an assignment for the benefit of creditors; may receive an order of the drawer stopping payment on the item; may have served on it an attachment of the account of the drawer; or the bank itself may exercise a right of setoff against the drawer's account. Each of these events affects the account of the drawer and may eliminate or freeze all or part of whatever balance is available to pay the item. Subsection (a) states the rule for determining the relative priorities between these various legal events and the item.

2. The rule is that if any one of several things has been done to the item or if it has reached any one of several stages in its processing at the time the knowledge, notice, stop-payment order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised, the knowledge, notice, stop-payment order, legal process or setoff comes too late, the item has priority and a charge to the customer's account may be made and is effective. With respect to the effect of the customer's bankruptcy, the bank's rights are governed by Bankruptcy Code Section 542(c) which codifies the result of **Bank of Marin v. England,** 385 U.S. 99 (1966). Section 4-405 applies to the death or incompetence of the customer.

3. Once a payor bank has accepted or certified an item or has paid the item in cash, the event has occurred that determines priorities between the item and the various legal events usually described as the "four legals." Paragraphs (1) and (2) of subsection (a) so provide. If a payor bank settles for an item presented over the counter for immediate payment by a cashier's check or teller's check which the presenting person agrees to accept, paragraph (3) of subsection (a) would control and the event determining priority has occurred. Because presentment was over the counter, Section 4-301(a) does not apply to give the payor bank the statutory right to revoke the settlement. Thus the requirements of paragraph

(3) have been met unless a clearing-house rule or agreement of the parties provides otherwise.

4. In the usual case settlement for checks is by entries in bank accounts. Since the process-of-posting test has been abandoned as inappropriate for automated check collection, the determining event for priorities is a given hour on the day after the item is received. (Paragraph (5) of subsection (a).) The hour may be fixed by the bank no earlier than one hour after the opening on the next banking day after the bank received the check and no later than the close of that banking day. If an item is received after the payor bank's regular Section 4-108 cutoff hour, it is treated as received the next banking day. If a bank receives an item after its regular cutoff hour on Monday and an attachment is levied at noon on Tuesday, the attachment is prior to the item if the bank had not before that hour taken the action described in paragraphs (1), (2), and (3) of subsection (a). The Commentary to Regulation CC Section 229.36(d) explains that even though settlement by a paying bank for a check is final for Regulation CC purposes, the paying bank's right to return the check before its midnight deadline under the UCC is not affected.

5. Another event conferring priority for an item and a charge to the customer's account based upon the item is stated by the language "become accountable for the amount of the item under Section 4-302 dealing with the payor bank's responsibility for late return of items." Expiration of the deadline under Section 4-302 with resulting accountability by the payor bank for the amount of the item, establishes priority of the item over notices, stop-payment orders, legal process or setoff.

6. In the case of knowledge, notice, stop-payment orders and legal process the effective time for determining whether they were received too late to affect the payment of an item and a charge to the customer's account by reason of such payment, is receipt plus a reasonable time for the bank to act on any of these communications. Usually a relatively short time is required to communicate to the accounting department advice of one of these events but certainly some time is necessary. Compare Sections 1-201(27) and 4-403. In the case of setoff the effective time is when the setoff is actually made.

7. As between one item and another no priority rule is stated. This is justified because of the impossibility of stating a rule that would be fair in all cases, having in mind the almost infinite number of combinations of large and small checks in relation to the available balance on hand in the drawer's account; the possible methods of receipt; and other variables. Further, the drawer has drawn all the checks, the drawer should have funds available to meet all of them and has no basis for urging one should be paid before another; and the holders have no direct right against the payor bank in any event, unless of course, the bank has accepted, certified or finally paid a particular item, or has become liable for it under Section 4-302. Under subsection (b) the bank has the right to pay items for which it is itself liable ahead of those for which it is not.

ANNOTATION

Law reviews. For article, "Setoff and Security Interests In Deposit Accounts", see 17 Colo. Law. 2108 (1988).

Because bank's right to setoff against taxpayer's account was not exercised in a timely and certain manner, the unexercised setoff does not have priority over federal administrative levy. U.S. v. Central Bank of Denver, 843 F.2d 1300 (10th Cir. 1988).

PART 4

RELATIONSHIP BETWEEN PAYOR BANK AND ITS CUSTOMER

4-4-401. When bank may charge customer's account. (a) A bank may charge against the account of a customer an item that is properly payable from that account even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and bank.

(b) A customer is not liable for the amount of an overdraft if the customer neither signed the item nor benefited from the proceeds of the item.

(c) A bank may charge against the account of a customer a check that is otherwise properly payable from the account, even though payment was made before the date of the check, unless the customer has given notice to the bank of the postdating describing the check with reasonable certainty. The notice is effective for the period stated in section 4-4-403 (b) for stop-payment orders, and must be received at such time and in such manner

as to afford the bank reasonable opportunity to act on it before the bank takes any action with respect to the check described in section 4-4-303. If a bank charges against the account of a customer a check before the date stated in the notice of postdating, the bank is liable for damages for the loss resulting from its act. The loss may include damages for dishonor of subsequent items under section 4-4-402.

(d) A bank that in good faith makes payment to a holder may charge the indicated account of its customer according to:

(1) The original terms of the altered item; or

(2) The terms of the completed item, even though the bank knows the item has been completed unless the bank has notice that the completion was improper.

Source: L. 94: Entire article amended with relocations, p. 899, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. An item is properly payable from a customer's account if the customer has authorized the payment and the payment does not violate any agreement that may exist between the bank and its customer. For an example of a payment held to violate an agreement with a customer, see **Torrance National Bank v. Enesco Federal Credit Union,** 285 P.2d 737 (Cal.App. 1955). An item drawn for more than the amount of a customer's account may be properly payable. Thus under subsection (a) a bank may charge the customer's account for an item even though payment results in an overdraft. An item containing a forged drawer's signature or forged indorsement is not properly payable. Concern has arisen whether a bank may require a customer to execute a stop-payment order when the customer notifies the bank of the loss of an unindorsed or specially indorsed check. Since such a check cannot be properly payable from the customer's account, it is inappropriate for a bank to require stop-payment order in such a case.

2. Subsection (b) adopts the view of case authority holding that if there is more than one customer who can draw on an account, the nonsigning customer is not liable for an overdraft unless that person benefits from the proceeds of the item.

3. Subsection (c) is added because the automated check collection system cannot accommodate postdated checks. A check is usually paid upon presentment without respect to the date of the check. Under the former law, if a payor bank paid a postdated check before its stated date, it could not charge the customer's account because the check was not "properly payable." Hence, the bank might have been liable for wrongfully dishonoring subsequent checks of the drawer that would have been paid had the postdated check not been prematurely paid. Under subsection (c) a customer wishing to postdate a check must notify the payor bank of its postdating in time to allow the bank to act on the customer's notice before the bank has to commit itself to pay the check. If the bank fails to act on the customer's timely notice, it may be liable for damages for the resulting loss which may include damages for dishonor of subsequent items. This Act does not regulate fees that banks charge their customers for a notice of postdating or other services covered by the Act, but under principles of law such as unconscionability or good faith and fair dealing, courts have reviewed fees and the bank's exercise of a discretion to set fees. **Perdue v. Crocker National Bank,** 38 Cal.3d 913 (1985) (unconscionability); **Best v. United Bank of Oregon,** 739 P.2d 554, 562-566 (1987) (good faith and fair dealing). In addition, Section 1-203 provides that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

4. Section 3-407(c) states that a payor bank or drawee which pays a fraudulently altered instrument in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed. Section 4-401(d) follows the rule stated in Section 3-407(c) by applying it to an altered item and allows the bank to enforce rights with respect to the altered item by charging the customer's account.

ANNOTATION

Law reviews. For article, "Payee v. Depository Bank: What is the UCC Defense to Handling Checks Bearing Forged Indorsements?", see 45 U. Colo. L. Rev. 281 (1974). For article, "Civil Liability for Check Forgeries in Colorado", see 16 Colo. Law. 959 (1987).

Customer's failure to prove loss. A partnership that could not meet its burden of proving

that a bank's improper payment of drafts drawn on the partnership's account caused the partnership to suffer a loss could not have its account recredited for the amount of the draft payments. Isaac v. Am. Heritage Bank & Trust Co., 675 P.2d 742 (Colo. 1984).

Liability of maker on instrument. Although a stop-payment order on a postdated check forbids payment by the bank to the payee or endorser, the maker remains liable on the instrument. Esecson v. Bushnell, 663 P.2d 258 (Colo. App. 1983).

4-4-402. Bank's liability to customer for wrongful dishonor - time of determining insufficiency of account. (a) Except as otherwise provided in this article, a payor bank wrongfully dishonors an item if it dishonors an item that is properly payable, but a bank may dishonor an item that would create an overdraft unless it has agreed to pay the overdraft.

(b) A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. Liability is limited to actual damages proved and may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case.

(c) A payor bank's determination of the customer's account balance on which a decision to dishonor for insufficiency of available funds is based may be made at any time between the time the item is received by the payor bank and the time that the payor bank returns the item or gives notice in lieu of return, and no more than one determination need be made. If, at the election of the payor bank, a subsequent balance determination is made for the purpose of reevaluating the bank's decision to dishonor the item, the account balance at that time is determinative of whether a dishonor for insufficiency of available funds is wrongful.

Source: L. 94: Entire article amended with relocations, p. 899, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. Subsection (a) states positively what has been assumed under the original Article: that if a bank fails to honor a properly payable item it may be liable to its customer for wrongful dishonor. Under subsection (b) the payor bank's wrongful dishonor of an item gives rise to a statutory cause of action. Damages may include consequential damages. Confusion has resulted from the attempts of courts to reconcile the first and second sentences of former Section 4-402. The second sentence implied that the bank was liable for some form of damages other than those proximately caused by the dishonor if the dishonor was other than by mistake. But nothing in the section described what these noncompensatory damages might be. Some courts have held that in distinguishing between mistaken dishonors and nonmistaken dishonors, the so-called "trader" rule has been retained that allowed a "merchant or trader" to recover substantial damages for wrongful dishonor without proof of damages actually suffered. Comment 3 to former Section 4-402 indicated that this was not the intent of the drafters. White & Summers, Uniform Commercial Code, Section 18-4 (1988), states: "The negative implication is that when wrongful dishonors occur not 'through mistake' but willfully, the court may impose damages greater than 'actual damages' ... . Certainly the reference to 'mistake' in the second sentence of 4-402 invites a court to adopt the relevant pre-Code distinction." Subsection (b) by deleting the reference to mistake in the second sentence precludes any inference that Section 4-402 retains the "trader" rule. Whether a bank is liable for noncompensatory damages, such as punitive damages, must be decided by Section 1-103 and Section 1-106 ("by other rule of law").

2. Wrongful dishonor is different from "failure to exercise ordinary care in handling an item," and the measure of damages is that stated in this section, not that stated in Section 4-103(e). By the same token, if a dishonor comes within this section, the measure of damages of this section applies and not another measure of damages. If the wrongful refusal of the beneficiary's bank to make funds available from a funds transfer causes the beneficiary's check to be dishonored, no specific guidance is given as to whether recovery is under this section or Article 4A. In each case this issue must be viewed in its factual context, and it was thought unwise to seek to establish certainty at the cost of fairness.

3. The second and third sentences of the subsection (b) reject decisions holding that as a matter of law the dishonor of a check is not the

"proximate cause" of the arrest and prosecution of the customer and leave to determination in each case as a question of fact whether the dishonor is or may be the "proximate cause."

4. Banks commonly determine whether there are sufficient funds in an account to pay an item after the close of banking hours on the day of presentment when they post debit and credit items to the account. The determination is made on the basis of credits available for withdrawal as of right or made available for withdrawal by the bank as an accommodation to its customer. When it is determined that payment of the item would overdraw the account, the item may be returned at any time before the bank's midnight deadline the following day. Before the item is returned new credits that are withdrawable as of right may have been added to the account. Subsection (c) eliminates uncertainty under Article 4 as to whether the failure to make a second determination before the item is returned on the day following presentment is a wrongful dishonor if new credits were added to the account on that day that would have covered the amount of the check.

5. Section 4-402 has been construed to preclude an action for wrongful dishonor by a plaintiff other than the bank's customer. **Loucks v. Albuquerque National Bank,** 418 P.2d 191 (N. Mex. 1966). Some courts have allowed a plaintiff other than the customer to sue when the customer is a business entity that is one and the same with the individual or individuals operating it. **Murdaugh Volkswagen, Inc. v. First National Bank,** 801 F.2d 719 (4th Cir. 1986) and **Karsh v. American City Bank,** 113 Cal. App. 3d 419, 169 Cal. Rptr. 851 (1980). However, where the wrongful dishonor impugns the reputation of an operator of the business, the issue is not merely, as the court in **Koger v. East First National Bank,** 443 So.2d 141 (Fla. App. 1983), put it, one of a literal versus a liberal interpretation of Section 4-402. Rather the issue is whether the statutory cause of action in Section 4-402 displaces, in accordance with Section 1-103, any cause of action that existed at common law in a person who is not the customer whose reputation was damaged. See **Marcum v. Security Trust and Savings Co.,** 221 Ala. 419, 129 So.74 (1930). While Section 4-402 should not be interpreted to displace the latter cause of action, the section itself gives no cause of action to other than a "customer," however that definition is construed, and thus confers no cause of action on the holder of a dishonored item. **First American National Bank v. Commerce Union Bank,** 692 S.W.2d 642 (Tenn. App. 1985).

ANNOTATION

Law reviews. For article, "Setoff and Security Interests In Deposit Accounts", see 17 Colo. Law. 2108 (1988).

4-4-403. Customer's right to stop payment - burden of proof of loss. (a) A customer or any person authorized to draw on the account if there is more than one person may stop payment of any item drawn on the customer's account or close the account by an order to the bank describing the item or account with reasonable certainty received at a time and in a manner that affords the bank a reasonable opportunity to act on it before any action by the bank with respect to the item described in section 4-4-303. If the signature of more than one person is required to draw on an account, any of these persons may stop payment or close the account.

(b) A stop-payment order is effective for six months, but it lapses after fourteen calendar days if the original order was oral and was not confirmed in writing within that period. A stop-payment order may be renewed for additional six-month periods by a writing given to the bank within a period during which the stop-payment order is effective.

(c) The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a stop-payment order or order to close an account is on the customer. The loss from payment of an item contrary to a stop-payment order may include damages for dishonor of subsequent items under section 4-4-402.

Source: L. 94: Entire article amended with relocations, p. 900, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. The position taken by this section is that stopping payment or closing an account is a service which depositors expect and are entitled to receive from banks notwithstanding its diffi-

culty, inconvenience and expense. The inevitable occasional losses through failure to stop or close should be borne by the banks as a cost of the business of banking.

2. Subsection (a) follows the decisions holding that a payee or indorsee has no right to stop payment. This is consistent with the provision governing payment or satisfaction. See Section 3-602. The sole exception to this rule is found in Section 4-405 on payment after notice of death, by which any person claiming an interest in the account can stop payment.

3. Payment is commonly stopped only on checks; but the right to stop payment is not limited to checks, and extends to any item payable by any bank. If the maker of a note payable at a bank is in a position analogous to that of a drawer (Section 4-106) the maker may stop payment of the note. By analogy the rule extends to drawees other than banks.

4. A cashier's check or teller's check purchased by a customer whose account is debited in payment for the check is not a check drawn on the customer's account within the meaning of subsection (a); hence, a customer purchasing a cashier's check or teller's check has no right to stop payment of such a check under subsection (a). If a bank issuing a cashier's check or teller's check refuses to pay the check as an accommodation to its customer or for other reasons, its liability on the check is governed by Section 3-411. There is no right to stop payment after certification of a check or other acceptance of a draft, and this is true no matter who procures the certification. See Sections 3-411 and 4-303. The acceptance is the drawee's own engagement to pay, and it is not required to impair its credit by refusing payment for the convenience of the drawer.

5. Subsection (a) makes clear that if there is more than one person authorized to draw on a customer's account any one of them can stop payment of any check drawn on the account or can order the account closed. Moreover, if there is a customer, such as a corporation, that requires its checks to bear the signatures of more than one person, any of these persons may stop payment on a check. In describing the item, the customer, in the absence of a contrary agreement, must meet the standard of what information allows the bank under the technology then existing to identify the item with reasonable certainty.

6. Under subsection (b), a stop-payment order is effective after the order, whether written or oral, is received by the bank and the bank has a reasonable opportunity to act on it. If the order is written it remains in effect for six months from that time. If the order is oral it lapses after 14 days unless there is written confirmation. If there is written confirmation within the 14-day period, the six-month period dates from the giving of the oral order. A stop-payment order may be renewed any number of times by written notice given during a six-month period while a stop order is in effect. A new stop-payment order may be given after a six-month period expires, but such a notice takes effect from the date given. When a stop-payment order expires it is as though the order had never been given, and the payor bank may pay the item in good faith under Section 4-404 even though a stop-payment order had once been given.

7. A payment in violation of an effective direction to stop payment is an improper payment, even though it is made by mistake or inadvertence. Any agreement to the contrary is invalid under Section 4-103(a) if in paying the item over the stop-payment order the bank has failed to exercise ordinary care. An agreement to the contrary which is imposed upon a customer as part of a standard form contract would have to be evaluated in the light of the general obligation of good faith. Sections 1-203 and 4-104(c). The drawee is, however, entitled to subrogation to prevent unjust enrichment (Section 4-407); retains common law defenses, e.g., that by conduct in recognizing the payment the customer has ratified the bank's action in paying over a stop-payment order (Section 1-103); and retains common law rights, e.g., to recover money paid under a mistake under Section 3-418. It has sometimes been said that payment cannot be stopped against a holder in due course, but the statement is inaccurate. The payment can be stopped but the drawer remains liable on the instrument to the holder in due course (Sections 3-305, 3-414) and the drawee, if it pays, becomes subrogated to the rights of the holder in due course against the drawer. Section 4-407. The relationship between Sections 4-403 and 4-407 is discussed in the Comments to Section 4-407. Any defenses available against a holder in due course remain available to the drawer, but other defenses are cut off to the same extent as if the holder were bringing the action.

4-4-404. Bank not obligated to pay check more than six months old. A bank is under no obligation to a customer having a checking account to pay a check, other than a certified check, which is presented more than six months after its date, but it may charge its customer's account for a payment made thereafter in good faith.

Source: L. 94: Entire article amended with relocations, p. 900, § 2, effective January 1, 1995.

OFFICIAL COMMENT

This section incorporates a type of statute that had been adopted in 26 jurisdictions before the Code. The time limit is set at six months because banking and commercial practice regards a check outstanding for longer than that period as stale, and a bank will normally not pay such a check without consulting the depositor. It is therefore not required to do so, but is given the option to pay because it may be in a position to know, as in the case of dividend checks, that the drawer wants payment made.

Certified checks are excluded from the section because they are the primary obligation of the certifying bank (Sections 3-409 and 3-413). The obligation runs directly to the holder of the check. The customer's account was presumably charged when the check was certified.

4-4-405. Death or incompetence of customer. (a) A payor or collecting bank's authority to accept, pay, or collect an item or to account for proceeds of its collection, if otherwise effective, is not rendered ineffective by incompetence of a customer of either bank existing at the time the item is issued or its collection is undertaken if the bank does not know of an adjudication of incompetence. Neither death nor incompetence of a customer revokes the authority to accept, pay, collect, or account until the bank knows of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on it.

(b) Even with knowledge, a bank may for ten days after the date of death pay or certify checks drawn on or before that date unless ordered to stop payment by a person claiming an interest in the account.

Source: L. 94: Entire article amended with relocations, p. 900, § 2, effective January 1, 1995. **L. 2004:** (a) amended, p. 400, § 1, effective July 1.

OFFICIAL COMMENT

1. Subsection (a) follows existing decisions holding that a drawee (payor) bank is not liable for the payment of a check before it has notice of the death or incompetence of the drawer. The justice and necessity of the rule are obvious. A check is an order to pay which the bank must obey under penalty of possible liability for dishonor. Further, with the tremendous volume of items handled any rule that required banks to verify the continued life and competency of drawers would be completely unworkable.

One or both of these same reasons apply to other phases of the bank collection and payment process and the rule is made wide enough to apply to these other phases. It applies to all kinds of "items"; to "customers" who own items as well as "customers" who draw or make them; to the function of collecting items as well as the function of accepting or paying them; to the carrying out of instructions to account for proceeds even though these may involve transfers to third parties; to depositary and intermediary banks as well as payor banks; and to incompetency existing at the time of the issuance of an item or the commencement of the collection or payment process as well as to incompetency occurring thereafter. Further, the requirement of actual knowledge makes inapplicable the rule of some cases that an adjudication of incompetency is constructive notice to all the world because obviously it is as impossible for banks to keep posted on such adjudications (in the absence of actual knowledge) as it is to keep posted as to death of immediate or remote customers.

2. Subsection (b) provides a limited period after death during which a bank may continue to pay checks (as distinguished from other items) even though it has notice. The purpose of the provision, as of the existing statutes, is to permit holders of checks drawn and issued shortly before death to cash them without the necessity of filing a claim in probate. The justification is that these checks normally are given in immediate payment of an obligation, that there is almost never any reason why they should not be paid, and that filing in probate is a useless formality, burdensome to the holder, the executor, the court and the bank.

This section does not prevent an executor or administrator from recovering the payment from the holder of the check. It is not intended to affect the validity of any gift causa mortis or other transfer in contemplation of death, but merely to relieve the bank of liability for the payment.

3. Any surviving relative, creditor or other person who claims an interest in the account may give a direction to the bank not to pay checks, or not to pay a particular check. Such notice has the same effect as a direction to stop payment. The bank has no responsibility to de-

termine the validity of the claim or even whether it is "colorable." But obviously anyone who has an interest in the estate, including the person named as executor in a will, even if the will has not yet been admitted to probate, is entitled to claim an interest in the account.

4-4-406. Customer's duty to discover and report unauthorized signature or alteration. (a) A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items paid or provide information in the statement of account sufficient to allow the customer reasonably to identify the items paid. The statement of account provides sufficient information if the item is described by item number, amount, and date of payment. If the bank does not return the items, it shall provide in the statement of account the telephone number that the customer may call to request an item or a legible copy thereof pursuant to subsection (b) of this section.

(b) If the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of seven years after receipt of the items. A customer may request an item from the bank that paid the item, and that bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy of the item. A bank shall provide, upon request and without charge to the customer, at least two items or a legible copy thereof with respect to each statement of account sent to the customer.

(c) If a bank sends or makes available a statement of account or items pursuant to subsection (a) of this section, the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized. If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts.

(d) If the bank proves that the customer failed, with respect to an item, to comply with the duties imposed on the customer by subsection (c) of this section, the customer is precluded from asserting against the bank:

(1) The customer's unauthorized signature or any alteration on the item, if the bank also proves that it suffered a loss by reason of the failure; and

(2) The customer's unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank if the payment was made before the bank received notice from the customer of the unauthorized signature or alteration and after the customer had been afforded a reasonable period of time, not exceeding thirty days, in which to examine the item or statement of account and notify the bank.

(e) If subsection (d) of this section applies and the customer proves that the bank failed to exercise ordinary care in paying the item and that failure contributed to loss, the loss is allocated between the customer precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with subsection (c) of this section and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (d) of this section does not apply.

(f) Without regard to care or lack of care of either the customer or the bank, a customer who does not within one year after the statement or items are made available to the customer (subsection (a) of this section) discover and report the customer's unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subsection (f), the payor bank may not recover for breach of warranty under section 4-4-208 with respect to the unauthorized signature or alteration to which the preclusion applies.

Source: L. 94: Entire article amended with relocations, p. 901, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. Under subsection (a), if a bank that has paid a check or other item for the account of a customer makes available to the customer a statement of account showing payment of the item, the bank must either return the item to the customer or provide a description of the item sufficient to allow the customer to identify it. Under subsection (c), the customer has a duty to exercise reasonable promptness in examining the statement or the returned item to discover any unauthorized signature of the customer or any alteration and to promptly notify the bank if the customer should reasonably have discovered the unauthorized signature or alteration.

The duty stated in subsection (c) becomes operative only if the "bank sends or makes available a statement of account or items pursuant to subsection (a)." A bank is not under a duty to send a statement of account or the paid items to the customer; but, if it does not do so, the customer does not have any duties under subsection (c).

Under subsection (a), a statement of account must provide information "sufficient to allow the customer reasonably to identify the items paid." If the bank supplies its customer with an image of the paid item, it complies with this standard. But a safe harbor rule is provided. The bank complies with the standard of providing "sufficient information" if "the item is described by item number, amount, and date of payment." This means that the customer's duties under subsection (c) are triggered if the bank sends a statement of account complying with the safe harbor rule without returning the paid items. A bank does not have to return the paid items unless it has agreed with the customer to do so. Whether there is such an agreement depends upon the particular circumstances. See Section 1-201(3). If the bank elects to provide the minimum information that is "sufficient" under subsection (a) and, as a consequence, the customer could not "reasonably have discovered the unauthorized payment," there is no preclusion under subsection (d). If the customer made a record of the issued checks on the check stub or carbonized copies furnished by the bank in the checkbook, the customer should usually be able to verify the paid items shown on the statement of account and discover any unauthorized or altered checks. But there could be exceptional circumstances. For example, if a check is altered by changing the name of the payee, the customer could not normally detect the fraud unless the customer is given the paid check or the statement of account discloses the name of the payee of the altered check. If the customer could not "reasonably have discovered the unauthorized payment" under subsection (c) there would not be a preclusion under subsection (d).

The "safe harbor" provided by subsection (a) serves to permit a bank, based on the state of existing technology, to trigger the customer's duties under subsection (c) by providing a "statement of account showing payment of items" without having to return the paid items, in any case in which the bank has not agreed with the customer to return the paid items. The "safe harbor" does not, however, preclude a customer under subsection (d) from asserting its unauthorized signature or an alteration against a bank in those circumstances in which under subsection (c) the customer should not "reasonably have discovered the unauthorized payment." Whether the customer has failed to comply with its duties under subsection (c) is determined on a case-by-case basis.

The provision in subsection (a) that a statement of account contains "sufficient information if the item is described by item number, amount, and date of payment" is based upon the existing state of technology. This information was chosen because it can be obtained by the bank's computer from the check's MICR line without examination of the items involved. The other two items of information that the customer would normally want to know — the name of the payee and the date of the item — cannot currently be obtained from the MICR line. The safe harbor rule is important in determining the feasibility of payor or collecting bank check retention plans. A customer who keeps a record of checks written, e.g., on the check stubs or carbonized copies of the checks supplied by the bank in the checkbook, will usually have sufficient information to identify the items on the basis of item number, amount, and date of payment. But customers who do not utilize these record-keeping methods may not. The policy decision is that accommodating customers who do not keep adequate records is not as desirable as accommodating customers who keep more careful records. This policy results in less cost to the check collection system and thus to all customers of the system. It is expected that technological advances such as image processing may make it possible for banks to give customers more information in the future in a manner that is fully compatible with automation or truncation systems. At that time the Permanent Editorial Board may wish to make recommendations for an amendment revising the safe harbor requirements in the light of those advances.

2. Subsection (d) states the consequences of a failure by the customer to perform its duty under subsection (c) to report an alteration or the customer's unauthorized signature. Subsection (d)(1) applies to the unauthorized payment of the item to which the duty to report under subsection (c) applies. If the bank proves that the customer "should reasonably have discovered

the unauthorized payment" (See Comment 1) and did not notify the bank, the customer is precluded from asserting against the bank the alteration or the customer's unauthorized signature if the bank proves that it suffered a loss as a result of the failure of the customer to perform its subsection (c) duty. Subsection (d)(2) applies to cases in which the customer fails to report an unauthorized signature or alteration with respect to an item in breach of the subsection (c) duty (See Comment 1) and the bank subsequently pays other items of the customer with respect to which there is an alteration or unauthorized signature of the customer and the same wrongdoer is involved. If the payment of the subsequent items occurred after the customer has had a reasonable time (not exceeding 30 days) to report with respect to the first item and before the bank received notice of the unauthorized signature or alteration of the first item, the customer is precluded from asserting the alteration or unauthorized signature with respect to the subsequent items.

If the customer is precluded in a single or multiple item unauthorized payment situation under subsection (d), but the customer proves that the bank failed to exercise ordinary care in paying the item or items and that the failure substantially contributed to the loss, subsection (e) provides a comparative negligence test for allocating loss between the customer and the bank. Subsection (e) also states that, if the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (d) does not apply.

Subsection (d)(2) changes former subsection (2)(b) by adopting a 30-day period in place of a 14-day period. Although the 14-day period may have been sufficient when the original version of Article 4 was drafted in the 1950s, given the much greater volume of checks at the time of the revision, a longer period was viewed as more appropriate. The rule of subsection (d)(2) follows pre-Code case law that payment of an additional item or items bearing an unauthorized signature or alteration by the same wrongdoer is a loss suffered by the bank traceable to the customer's failure to exercise reasonable care (See Comment 1) in examining the statement and notifying the bank of objections to it. One of the most serious consequences of failure of the customer to comply with the requirements of subsection (c) is the opportunity presented to the wrongdoer to repeat the misdeeds. Conversely, one of the best ways to keep down losses in this type of situation is for the customer to promptly examine the statement and notify the bank of an unauthorized signature or alteration so that the bank will be alerted to stop paying further items. Hence, the rule of subsection (d)(2) is prescribed, and to avoid dispute a specific time limit, 30 days, is designated for cases to which the subsection applies. These considerations are not present if there are no losses resulting from the payment of additional items. In these circumstances, a reasonable period for the customer to comply with its duties under subsection (c) would depend on the circumstances (Section 1-204(2)) and the subsection (d)(2) time limit should not be imported by analogy into subsection (c).

3. Subsection (b) applies if the items are not returned to the customer. Check retention plans may include a simple payor bank check retention plan or the kind of check retention plan that would be authorized by a truncation agreement in which a collecting bank or the payee may retain the items. Even after agreeing to a check retention plan, a customer may need to see one or more checks for litigation or other purposes. The customer's request for the check may always be made to the payor bank. Under subsection (b) retaining banks may destroy items but must maintain the capacity to furnish legible copies for seven years. A legible copy may include an image of an item. This Act does not define the length of the reasonable period of time for a bank to provide the check or copy of the check. What is reasonable depends on the capacity of the bank and the needs of the customer. This Act does not specify sanctions for failure to retain or furnish the items or legible copies; this is left to other laws regulating banks. See Comment 3 to Section 4-101. Moreover, this Act does not regulate fees that banks charge their customers for furnishing items or copies or other services covered by the Act, but under principles of law such as unconscionability or good faith and fair dealing, courts have reviewed fees and the bank's exercise of a discretion to set fees. **Perdue v. Crocker National Bank,** 38 Cal.3d 913 (1985) (unconscionability); **Best v. United Bank of Oregon,** 739 P.2d 554, 562-566 (1987) (good faith and fair dealing). In addition, Section 1-203 provides that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

4. Subsection (e) replaces former subsection (3) and poses a modified comparative negligence test for determining liability. See the discussion on this point in the Comments to Sections 3-404, 3-405, and 3-406. The term "good faith" is defined in Section 3-103(a)(4) as including "observance of reasonable commercial standards of fair dealing." The connotation of this standard is fairness and not absence of negligence.

The term "ordinary care" used in subsection (e) is defined in Section 3-103(a)(7), made applicable to Article 4 by Section 4-104(c), to provide that sight examination by a payor bank is not required if its procedure is reasonable and is commonly followed by other comparable banks in the area. The case law is divided on this issue. The definition of "ordinary care" in Sec-

tion 3-103 rejects those authorities that hold, in effect, that failure to use sight examination is negligence as a matter of law. The effect of the definition of "ordinary care" on Section 4-406 is only to provide that in the small percentage of cases in which a customer's failure to examine its statement or returned items has led to loss under subsection (d) a bank should not have to share that loss solely because it has adopted an automated collection or payment procedure in order to deal with the great volume of items at a lower cost to all customers.

5. Several changes are made in former Section 4-406(5). First, former subsection (5) is deleted and its substance is made applicable only to the one-year notice preclusion in former subsection (4) (subsection (f)). Thus if a drawer has not notified the payor bank of an unauthorized check or material alteration within the one-year period, the payor bank may not choose to recredit the drawer's account and pass the loss to the collecting banks on the theory of breach of warranty. Second, the reference in former subsection (4) to unauthorized indorsements is deleted. Section 4-406 imposes no duties on the drawer to look for unauthorized indorsements. Section 4-111 sets out a statute of limitations allowing a customer a three-year period to seek a credit to an account improperly charged by payment of an item bearing an unauthorized indorsement. Third, subsection (c) is added to Section 4-208 to assure that if a depositary bank is sued for breach of a presentment warranty, it can defend by showing that the drawer is precluded by Section 3-406 or Section 4-406(c) and (d).

ANNOTATION

Law reviews. For article, "Civil Liability for Check Forgeries in Colorado", see 16 Colo. Law. 959 (1987).

Bank's lack of ordinary care estops defense of contributory negligence. Where a bank did not exercise ordinary care in approving drafts drawn on a partnership's account, the bank is estopped from asserting that one of the partners was contributorily negligent in allowing it to pay the drafts on the other partner's signature. Am. Heritage Bank & Trust Co. v. Isaac, 636 P.2d 1296 (Colo. App. 1981).

4-4-407. Payor bank's right to subrogation on improper payment. If a payor bank has paid an item over the order of the drawer or maker to stop payment, or after an account has been closed, or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank is subrogated to the rights:

(1) Of any holder in due course on the item against the drawer or maker;

(2) Of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and

(3) Of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

Source: L. 94: Entire article amended with relocations, p. 903, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. Section 4-403 states that a stop-payment order or an order to close an account is binding on a bank. If a bank pays an item over such an order it is prima facie liable, but under subsection (c) of Section 4-403 the burden of establishing the fact and amount of loss from such payment is on the customer. A defense frequently interposed by a bank in an action against it for wrongful payment over a stop-payment order is that the drawer or maker suffered no loss because it would have been liable to a holder in due course in any event. On this argument some cases have held that payment cannot be stopped against a holder in due course. Payment can be stopped, but if it is, the drawer or maker is liable and the sound rule is that the bank is subrogated to the rights of the holder in due course. The preamble and paragraph (1) of this section state this rule.

2. Paragraph (2) also subrogates the bank to the rights of the payee or other holder against the drawer or maker either on the item or under the transaction out of which it arose. It may well be that the payee is not a holder in due course but still has good rights against the drawer. These may be on the check but also may not be as, for example, where the drawer buys goods from the payee and the goods are partially defective so that the payee is not entitled to the full price, but the goods are still worth a portion of

the contract price. If the drawer retains the goods it is obligated to pay a part of the agreed price. If the bank has paid the check it should be subrogated to this claim of the payee against the drawer.

3. Paragraph (3) subrogates the bank to the rights of the drawer or maker against the payee or other holder with respect to the transaction out of which the item arose. If, for example, the payee was a fraudulent salesman inducing the drawer to issue a check for defective securities, and the bank pays the check over a stop-payment order but reimburses the drawer for such payment, the bank should have a basis for getting the money back from the fraudulent salesman.

4. The limitations of the preamble prevent the bank itself from getting any double recovery or benefits out of its subrogation rights conferred by the section.

5. The spelling out of the affirmative rights of the bank in this section does not destroy other existing rights (Section 1-103). Among others these may include the defense of a payor bank that by conduct in recognizing the payment a customer has ratified the bank's action in paying in disregard of a stop-payment order or right to recover money paid under a mistake.

PART 5

COLLECTION OF DOCUMENTARY DRAFTS

4-4-501. Handling of documentary drafts - duty to send for presentment and to notify customer of dishonor. A bank that takes a documentary draft for collection shall present or send the draft and accompanying documents for presentment and, upon learning that the draft has not been paid or accepted in due course, shall seasonably notify its customer of the fact even though it may have discounted or bought the draft or extended credit available for withdrawal as of right.

Source: L. 94: Entire article amended with relocations, p. 903, § 2, effective January 1, 1995.

OFFICIAL COMMENT

This section states the duty of a bank handling a documentary draft for a customer. "Documentary draft" is defined in Section 4-104. The duty stated exists even if the bank has bought the draft. This is because to the customer the draft normally represents an underlying commercial transaction, and if that is not going through as planned the customer should know it promptly.

4-4-502. Presentment of "on arrival" drafts. If a draft or the relevant instructions require presentment "on arrival", "when goods arrive", or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired. Refusal to pay or accept because the goods have not arrived is not dishonor; the bank must notify its transferor of the refusal but need not present the draft again until it is instructed to do so or learns of the arrival of the goods.

Source: L. 94: Entire article amended with relocations, p. 903, § 2, effective January 1, 1995.

OFFICIAL COMMENT

The section is designed to establish a definite rule for "on arrival" drafts. The term includes not only drafts drawn payable "on arrival" but also drafts forwarded with instructions to present "on arrival." The term refers to the arrival of the relevant goods. Unless a bank has actual knowledge of the arrival of the goods, as for example, when it is the "notify" party on the bill of lading, the section only requires the exercise of such judgment in estimating time as a bank may be expected to have. Commonly the buyer-drawee will want the goods and will therefore call for the documents and take up the draft when they do arrive.

4-4-503. Responsibility of presenting bank for documents and goods - report of reason for dishonor - referee in case of need. Unless otherwise instructed and except as provided in article 5 of this title, a bank presenting a documentary draft:

(1) Must deliver the documents to the drawee on acceptance of the draft if it is payable more than three days after presentment - otherwise only on payment; and

(2) Upon dishonor, either in the case of presentment for acceptance or presentment for payment, may seek and follow instructions from any referee in case of need designated in the draft or if the presenting bank does not choose to utilize the referee's services, it must use diligence and good faith to ascertain the reason for dishonor, must notify its transferor of the dishonor and of the results of its effort to ascertain the reasons therefor, and must request instructions.

However the presenting bank is under no obligation with respect to goods represented by the documents except to follow any reasonable instructions seasonably received; it has a right to reimbursement for any expense incurred in following instructions and to prepayment of or indemnity for those expenses.

Source: L. 94: Entire article amended with relocations, p. 903, § 2, effective January 1, 1995.

OFFICIAL COMMENT

1. This section states the rules governing, in the absence of instructions, the duty of the presenting bank in case either of honor or of dishonor of a documentary draft. The section should be read in connection with Section 2-514 on when documents are deliverable on acceptance, when on payment.

2. If the draft is drawn under a letter of credit, Article 5 controls. See Sections 5-109 through 5-114.

4-4-504. Privilege of presenting bank to deal with goods - security interest for expenses. (a) A presenting bank that, following the dishonor of a documentary draft, has seasonably requested instructions but does not receive them within a reasonable time may store, sell, or otherwise deal with the goods in any reasonable manner.

(b) For its reasonable expenses incurred by action under subsection (a) of this section, the presenting bank has a lien upon the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien.

Source: L. 94: Entire article amended with relocations, p. 904, § 2, effective January 1, 1995.

OFFICIAL COMMENT

The section gives the presenting bank, after dishonor, a privilege to deal with the goods in any commercially reasonable manner pending instructions from its transferor and, if still unable to communicate with its principal after a reasonable time, a right to realize its expenditures as if foreclosing on an unpaid seller's lien (Section 2-706). The provision includes situations in which storage of goods or other action becomes commercially necessary pending receipt of any requested instructions, even if the requested instructions are later received.

The "reasonable manner" referred to means one reasonable in the light of business factors and the judgment of a business man.

ARTICLE 4.5

Funds Transfers

Editor's note: The National Conference of Commissioners on Uniform State Laws numbered this article as "4A". In C.R.S., it is numbered as article "4.5". References in the OFFICIAL COMMENTS to specific sections can be translated to C.R.S. numbers by changing "4A" to "4.5" and, where necessary, adding the appropriate title of C.R.S. For example, a reference in an OFFICIAL COMMENT to section "4A-101" would translate to section "4-4.5-101".

Law reviews: For article, "New Article 4.5 of the UCC: Funds Transfers", see 20 Colo. Law. 457 (1991).

OFFICIAL COMMENT
ARTICLE 4A - FUNDS TRANSFERS
PREFATORY NOTE

The National Conference of Commissioners on Uniform State laws and The American Law Institute have approved a new Article 4A to the Uniform Commercial Code (numbered as article 4.5 in C.R.S.). Comments that follow each of the sections of the statute are intended as official

comments. They explain in detail the purpose and meaning of the various sections and the policy considerations on which they are based.

Description of transaction covered by Article 4A.

There are a number of mechanisms for making payments through the banking system. Most of these mechanisms are covered in whole or part by state or federal statutes. In terms of number of transactions, payments made by check or credit card are the most common payment methods. Payment by check is covered by Articles 3 and 4 of the UCC and some aspects of payment by credit card are covered by federal law. In recent years electronic funds transfers have been increasingly common in consumer transactions. For example, in some cases a retail customer can pay for purchases by use of an access or debit card inserted in a terminal at the retail store that allows the bank account of the customer to be instantly debited. Some aspects of these point-of-sale transactions and other consumer payments that are effected electronically are covered by a federal statute, the Electronic Fund Transfer Act (EFTA). If any part of a funds transfer is covered by EFTA, the entire funds transfer is excluded from Article 4A.

Another type of payment, commonly referred to as a wholesale wire transfer, is the primary focus of Article 4A. Payments that are covered by Article 4A are overwhelmingly between business or financial institutions. The dollar volume of payments made by wire transfer far exceeds the dollar volume of payments made by other means. The volume of payments by wire transfer over the two principal wire payment systems — the Federal Reserve wire transfer network (Fedwire) and the New York Clearing House Interbank Payments Systems (CHIPS) — exceeds one trillion dollars per day. Most payments carried out by use of automated clearing houses are consumer payments covered by EFTA and therefore not covered by Article 4A. There is, however, a significant volume of non-consumer ACH payments that closely resemble wholesale wire transfers. These payments are also covered by Article 4A.

There is some resemblance between payments made by wire transfer and payments made by other means such as paper-based checks and credit cards or electronically-based consumer payments, but there are also many differences. Article 4A excludes from its coverage these other payment mechanisms. Article 4A follows a policy of treating the transaction that it covers — a "funds transfer" — as a unique method of payment that is governed by unique principles of law that address the operational and policy issues presented by this kind of payment.

The funds transfer that is covered by Article 4A is not a complex transaction and can be illustrated by the following example which is used throughout the Prefatory Note as a basis for discussion. X, a debtor, wants to pay an obligation owed to Y. Instead of delivering to Y a negotiable instrument such as a check or some other writing such as a credit card slip that enables Y to obtain payment from a bank, X transmits an instruction to X's bank to credit a sum of money to the bank account of Y. In most cases X's bank and Y's bank are different banks. X's bank may carry out X's instruction by instructing Y's bank to credit Y's account in the amount that X requested. The instruction that issues to its bank is a "payment order." X is the "sender" of the payment order and X's bank is the "receiving bank" with respect to X's order. Y is the "beneficiary" of X's order. When X's bank issues an instruction to Y's bank to carry out X's payment order, X's bank "executes" X's order. The instruction of X's bank to Y's bank is also a payment order. With respect to that order, X's bank is the sender, Y's bank is the receiving bank, and Y is the beneficiary. The entire series of transactions by which X pays Y is known as the "funds transfer." With respect to the funds transfer, X is the "originator", X's bank is the "originators bank," Y is the "beneficiary" and Y's bank is the "beneficiary's bank." In more complex transactions there are one or more additional banks known as "intermediary banks" between X's bank and Y's bank. In the funds transfer the instruction contained in the payment order of X to its bank is carried out by a series of payment orders by each bank in the transmission chain to the next bank in the chain until Y's bank receives a payment order to make the credit to Y's account. In most cases, the payment order of each bank to the next bank in the chain is transmitted electronically, and often the payment order of X to its bank is also transmitted electronically, but the means of transmission does not have any legal significance. A payment order may be transmitted by any means, and in some cases the payment order is transmitted by a slow means such as first class mail. To reflect this fact, the broader term "funds transfer" rather than the narrower term "wire transfer" is used in Article 4A to describe the overall payment transaction.

Funds transfers are divided into two categories determined by whether the instruction to pay is given by the person making payment or the person receiving payment. If the instruction is given by the person making the payment, the transfer is commonly referred to as a "credit transfer". If the instruction is given by the person receiving payment, the transfer is commonly referred to as a "debit transfer." Article 4A governs credit transfers and excludes debit transfers.

Why is Article 4A needed?

There is no comprehensive body of law that defines the rights and obligations that arise from

wire transfers. Some aspects of wire transfers are governed by rules of the principal transfer systems. Transfers made by Fedwire are governed by Federal Reserve Regulation J and transfers over CHIPS are governed by the CHIPS rules. Transfers made by means of automated clearing houses are governed by uniform rules adopted by various associations of banks in various parts of the nation or by Federal Reserve rules or operating circulars. But the various funds transfer system rules apply to only limited aspects of wire transfer transactions. The resolution of the many issues that are not covered by funds transfer system rules depends on contracts of the parties, to the extent that they exist, or principles of law applicable to other payment mechanisms that might be applied by analogy. The result is a great deal of uncertainty. There is no consensus about the juridical nature of a wire transfer and consequently of the rights and obligations that are created. Article 4A is intended to provide the comprehensive body of law that we do not have today.

Characteristics of a funds transfer.

There are a number of characteristics of funds transfers covered by Article 4A that have influenced the drafting of the statute. The typical funds transfer involves a large amount of money. Multimillion dollar transactions are commonplace. The originator of the transfer and the beneficiary are typically sophisticated business or financial organizations. High speed is another predominant characteristic. Most funds transfers are completed on the same day, even in complex transactions in which there are several intermediary banks in the transmission chain. A funds transfer is a highly efficient substitute for payments made by the delivery of paper instruments. Another characteristic is extremely low cost. A transfer that involves many millions of dollars can be made for a price of a few dollars. Price does not normally vary very much or at all with the amount of the transfer. This system of pricing may not be feasible if the bank is exposed to very large liabilities in connection with the transaction. The pricing system assumes that the price reflects primarily the cost of the mechanical operation performed by the bank, but in fact, a bank may have more or less potential liability with respect to a funds transfer depending upon the amount of the transfer. Risk of loss to banks carrying out a funds transfer may arise from a variety of causes. In some funds transfers, there may be extensions of very large amounts of credit for short periods of time by the banks that carry out a funds transfer. If a payment order is issued to the beneficiary's bank, it is normal for the bank to release funds to the beneficiary immediately. Sometimes, payment to the beneficiary's bank by the bank that issued the order to the beneficiary's bank is delayed until the end of the day. If that payment is not received because of the insolvency of the bank that is obliged to pay, the beneficiary's bank may suffer a loss. There is also risk of loss if a bank fails to execute the payment order of a customer, or if the order is executed late. There also may be an error in the payment order issued by a bank that is executing the payment order of its customer. For example, the error might relate to the amount to be paid or to the identity of the person to be paid. Because the dollar amounts involved in funds transfers are so large, the risk of loss if something goes wrong in a transaction may also be very large. A major policy issue in the drafting of Article 4A is that of determining how risk of loss is to be allocated given the price structure in the industry.

Concept of acceptance and effect of acceptance by the beneficiary's bank.

Rights and obligations under Article 4A arise as the result of "acceptance" of a payment order by the bank to which the order is addressed. Section 4A-209. The effect of acceptance varies depending upon whether the payment order is issued to the beneficiary's bank or to a bank other than the beneficiary's bank. Acceptance by the beneficiary's bank is particularly important because it defines when the beneficiary's bank becomes obligated to the beneficiary to pay the amount of the payment order. Although Article 4A follows convention in using the term "funds transfer" to identify the payment from X to Y that is described above, no money or property right of X is actually transferred to Y. X pays Y by causing Y's bank to become indebted to Y in the amount of the payment. This debt arises when Y's bank accepts the payment order that X's bank issued to Y's bank to execute X's order. If the funds transfer was carried out by use of one or more intermediary banks between X's bank and Y's bank, Y's bank becomes indebted to Y when Y's bank accepts the payment order issued to it by an intermediary bank. The funds transfer is completed when this debt is incurred. Acceptance, the event that determines when the debt of Y's bank to Y arises, occurs (i) when Y's bank pays Y or notifies Y of receipt of the payment order, or (ii) when Y's bank receives payment from the bank that issued a payment order to Y's bank.

The only obligation of the beneficiary's bank that results from acceptance of a payment order is to pay the amount of the order to the beneficiary. No obligation is owed to either the sender of the payment order accepted by the beneficiary's bank or to the originator of the funds transfer. The obligation created by acceptance by the beneficiary's bank is for the benefit of the beneficiary. The purpose of the sender's payment order is to effect payment by the originator to the beneficiary and that purpose is achieved when the beneficiary's bank accepts the payment order. Section 4A-405 states rules for determining when the obligation of the beneficiary's bank to the beneficiary has been paid.

Acceptance by a bank other than the beneficiary's bank.

In the funds transfer described above, what is the obligation of X's bank when it receives X's payment order? Funds transfers by a bank on behalf of its customer are made pursuant to an agreement or arrangement that may or may not be reduced to a formal document signed by the parties. It is probably true that in most cases there is either no express agreement or the agreement addresses only some aspects of the transaction. Substantial risk is involved in funds transfers and a bank may not be willing to give this service to all customers, and may not be willing to offer it to any customer unless certain safeguards against loss such as security procedures are in effect. Funds transfers often involve the giving of credit by the receiving bank to the customer, and that also may involve an agreement. These considerations are reflected in Article 4A by the principle that, in the absence of a contrary agreement, a receiving bank does not incur liability with respect to a payment order until it accepts it. If X and X's bank in the hypothetical case had an agreement that obliged the bank to act on X's payment orders and the bank failed to comply with the agreement, the bank can be held liable for breach of the agreement. But apart from any obligation arising by agreement, the bank does not incur any liability with respect to X's payment order until the bank accepts the order. X's payment order is treated by Article 4A as a request by X to the bank to take action that will cause X's payment order to be carried out. That request can be accepted by X's bank by "executing" X's payment order. Execution occurs when X's bank sends a payment order to Y's bank intended by X's bank to carry out the payment order of X. X's bank could also execute X's payment order by issuing a payment order to an intermediary bank instructing the intermediary bank to instruct Y's bank to make the credit to Y's account. In that case execution and acceptance of X's order occur when the payment order of X's bank is sent to the intermediary bank. When X's bank executes X's payment order the bank is entitled to receive payment from and may debit an authorized account of X. If X's bank does not execute X's order and the amount of the order is covered by a withdrawable credit balance in X's authorized account, the bank must pay X interest on the money represented by X's order unless X is given prompt notice of rejection of the order. Section 4A-210(b).

Bank error in funds transfers.

If a bank, other than the beneficiary's bank, accepts a payment order, the obligations and liabilities are owed to the originator of the funds transfer. Assume in the example stated above, that X's bank executes X's payment order by issuing a payment order to an intermediary bank that executes the order of X's bank by issuing a payment order to Y's bank. The obligations of X's bank with respect to execution are owed to X. The obligations of the intermediary bank with respect to execution are also owed to X. Section 4A-302 states standards with respect to the time and manner of execution of payment orders. Section 4A-305 states the measure of damages for improper execution. It also states that a receiving bank is liable for damages if it fails to execute a payment order that it was obliged by express agreement to execute. In each case consequential damages are not recoverable unless an express agreement of the receiving bank provides for them. The policy basis for this limitation is discussed in Comment 2 to Section 4A-305.

Error in the consummation of a funds transfer is not uncommon. There may be a discrepancy in the amount that the originator orders to be paid to the beneficiary and the amount that the beneficiary's bank is ordered to pay. For example, if the originator's payment order instructs payment of $100,000 and the payment order of the originator's bank instructs payment of $1,000,000, the originator's bank is entitled to receive only $100,000 from the originator and has the burden of recovering the additional $900,000 paid to the beneficiary by mistake. In some cases the originator's bank or an intermediary bank instructs payment to a beneficiary other than the beneficiary stated in the originator's payment order. If the wrong beneficiary is paid the bank that issued the erroneous payment order is not entitled to receive payment of the payment order that it executed and has the burden of recovering the mistaken payment. The originator is not obliged to pay its payment order. Section 4A-303 and Section 4A-207 state rules for determining the rights and obligations of the various parties to the funds transfer in these cases and in other typical cases in which error is made.

Pursuant to Section 4A-402(c) the originator is excused from the obligation to pay the originator's bank if the funds transfer is not completed, i.e. payment by the originator to the beneficiary is not made. Payment by the originator to the beneficiary occurs when the beneficiary's bank accepts a payment order for the benefit of the beneficiary of the originator's payment order. Section 4A-406. If for any reason that acceptance does not occur, the originator is not required to pay the payment order that it issued or, if it already paid, is entitled to refund of the payment with interest. This "money-back guarantee" is an important protection of the originator of a funds transfer. The same rule applies to any other sender in the funds transfer. Each sender's obligation to pay is excused if the beneficiary's bank does not accept a payment order for the benefit of the beneficiary of that sender's order. There is an important exception to this rule. It is common

practice for the originator of a funds transfer to designate the intermediary bank or banks through which the funds transfer is to be routed. The originator's bank is required by Section 4A-302 to follow the instruction of the originator with respect to intermediary banks. If the originator's bank sends a payment order to the intermediary bank designated in the originator's order and the intermediary bank causes the funds transfer to miscarry by failing to execute the payment order or by instructing payment to the wrong beneficiary, the originator's bank is not required to pay its payment order and if it has already paid it is entitled to recover payment from the intermediary bank. This remedy is normally adequate, but if the originator's bank already paid its order and the intermediary bank has suspended payments or is not permitted by law to refund payment, the originator's bank will suffer a loss. Since the originator required the originator's bank to use the failed intermediary bank, Section 4A-402(e) provides that in this case the originator is obliged to pay its payment order and has a claim against the intermediary bank for the amount of the order. The same principle applies to any other sender that designates a subsequent intermediary bank.

Unauthorized payment orders.

An important issue addressed in Section 4A-202 and Section 4A-203 is how the risk of loss from unauthorized payment orders is to be allocated. In a large percentage of cases, the payment order of the originator of the funds transfer is transmitted electronically to the originator's bank. In these cases it may not be possible for the bank to know whether the electronic message has been authorized by its customer. To ensure that no unauthorized person is transmitting messages to the bank, the normal practice is to establish security procedures that usually involve the use of codes or identifying numbers or words. If the bank accepts a payment order that purports to be that of its customer after verifying its authenticity by complying with a security procedure agreed to by the customer and the bank, the customer is bound to pay the order even if it was not authorized. But there is an important limitation on this rule. The bank is entitled to payment in the case of an unauthorized order only if the court finds that the security procedure was a commercially reasonable method of providing security against unauthorized payment orders. The customer can also avoid liability if it can prove that the unauthorized order was not initiated by an employee or other agent of the customer having access to confidential security information or by a person who obtained that information from a source controlled by the customer. The policy issues are discussed in the comments following Section 4A-203. If the bank accepts an unauthorized payment order without verifying it in compliance with a security procedure, the loss falls on the bank.

Security procedures are also important in cases of error in the transmission of payment orders. There may be an error by the sender in the amount of the order, or a sender may transmit a payment order and then erroneously transmit a duplicate of the order. Normally, the sender is bound by the payment order even if it is issued by mistake. But in some cases an error of this kind can be detected by a security procedure. Although the receiving bank is not obliged to provide a security procedure for the detection of error, if such a procedure is agreed to by the bank Section 4A-205 provides that if the error is not detected because the receiving bank does not comply with the procedure, any resulting loss is borne by the bank failing to comply with the security procedure.

Insolvency losses.

Some payment orders do not involve the granting of credit to the sender by the receiving bank. In those cases, the receiving bank accepts the sender's order at the same time the bank receives payment of the order. This is true of a transfer of funds by Fedwire or of cases in which the receiving bank can debit a funded account of the sender. But in some cases the granting of credit is the norm. This is true of a payment order over CHIPS. In a CHIPS transaction the receiving bank usually will accept the order before receiving payment from the sending bank. Payment is delayed until the end of the day when settlement is made through the Federal Reserve System. If the receiving bank is an intermediary bank, it will accept by issuing a payment order to another bank and the intermediary bank is obliged to pay that payment order. If the receiving bank is the beneficiary's bank, the bank usually will accept by releasing funds to the beneficiary before the bank has received payment. If a sending bank suspends payments before settling its liabilities at the end of the day, the financial stability of banks that are net creditors of the insolvent bank may also be put into jeopardy, because the dollar volume of funds transfers between the banks may be extremely large. With respect to two banks that are dealing with each other in a series of transactions in which each bank is sometimes a receiving bank and sometimes a sender, the risk of insolvency can be managed if amounts payable as a sender and amounts receivable as a receiving bank are roughly equal. But if these amounts are significantly out of balance, a net creditor bank may have a very significant credit risk during the day before settlement occurs. The Federal Reserve System and the banking community are greatly concerned with this risk, and various measures have been instituted to reduce this credit exposure. Article 4A also addresses this problem. A receiving bank can always avoid this risk by delaying acceptance of a payment order until

after the bank has received payment. For example, if the beneficiary's bank credits the beneficiary's account it can avoid acceptance by not notifying the beneficiary of the receipt of the order or by notifying the beneficiary that the credit may not be withdrawn until the beneficiary's bank receives payment. But if the beneficiary's bank releases funds to the beneficiary before receiving settlement, the result in a funds transfer other than a transfer by means of an automated clearing house or similar provisional settlement system is that the beneficiary's bank may not recover the funds if it fails to receive settlement. This rule encourages the banking system to impose credit limitations on banks that issue payment orders. These limitations are already in effect. CHIPS has also proposed a loss-sharing plan to be adopted for implementation in the second half of 1990 under which CHIPS participants will be required to provide funds necessary to complete settlement of the obligations of one or more participants that are unable to meet settlement obligations. Under this plan, it will be a virtual certainty that there will be settlement on CHIPS in the event of failure by a single bank. Section 4A-403(b) and (c) are also addressed to reducing risks of insolvency. Under these provisions the amount owed by a failed bank with respect to payment orders it issued is the net amount owing after setting off amounts owed to the failed bank with respect to payment orders it received. This rule allows credit exposure to be managed by limitations on the net debit position of a bank.

PART 1

SUBJECT MATTER AND DEFINITIONS

4-4.5-101. Short title. This article may be cited as "Uniform Commercial Code — Funds Transfers".

Source: L. 90: Entire article added, p. 342, § 1, effective January 1, 1991.

4-4.5-102. Subject matter. Except as otherwise provided in section 4-4.5-108, this article applies to funds transfers defined in section 4-4.5-104.

Source: L. 90: Entire article added, p. 342, § 1, effective January 1, 1991.

OFFICIAL COMMENT

Article 4A governs a specialized method of payment referred to in the Article as a funds transfer but also commonly referred to in the commercial community as a wholesale wire transfer. A funds transfer is made by means of one or more payment orders. The scope of Article 4A is determined by the definitions of "payment order" and "funds transfer" found in Section 4A-103 and Section 4A-104.

The funds transfer governed by Article 4A is in large part a product of recent and developing technological changes. Before this Article was drafted there was no comprehensive body of law — statutory or judicial — that defined the juridical nature of a funds transfer or the rights and obligations flowing from payment orders. Judicial authority with respect to funds transfers is sparse, undeveloped and not uniform. Judges have had to resolve disputes by referring to general principles of common law or equity, or they have sought guidance in statutes such as Article 4 which are applicable to other payment methods. But attempts to define rights and obligations in funds transfers by general principles or by analogy to rights and obligations in negotiable instrument law or the law of check collection have not been satisfactory.

In the drafting of Article 4A, a deliberate decision was made to write on a clean slate and to treat a funds transfer as a unique method of payment to be governed by unique rules that address the particular issues raised by this method of payment. A deliberate decision was also made to use precise and detailed rules to assign responsibility, define behavioral norms, allocate risks and establish limits on liability, rather than to rely on broadly stated, flexible principles. In the drafting of these rules, a critical consideration was that the various parties to funds transfers need to be able to predict risk with certainty, to insure against risk, to adjust operational and security procedures, and to price funds transfer services appropriately. This consideration is particularly important given the very large amounts of money that are involved in funds transfers.

Funds transfers involve competing interests — those of the banks that provide funds transfer services and the commercial and financial organizations that use the services, as well as the public interest. These competing interests were represented in the drafting process and they were thoroughly considered. The rules that

emerged represent a careful and delicate balancing of those interests and are intended to be the exclusive means of determining the rights, duties and liabilities of the affected parties in any situation covered by particular provisions of the Article. Consequently, resort to principles of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article.

4-4.5-103. Payment order - definitions. (a) In this article:

(1) "Payment order" means an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary if:

(i) The instruction does not state a condition to payment to the beneficiary other than time of payment,

(ii) The receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and

(iii) The instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank.

(2) "Beneficiary" means the person to be paid by the beneficiary's bank.

(3) "Beneficiary's bank" means the bank identified in a payment order in which an account of the beneficiary is to be credited pursuant to the order or which otherwise is to make payment to the beneficiary if the order does not provide for payment to an account.

(4) "Receiving bank" means the bank to which the sender's instruction is addressed.

(5) "Sender" means the person giving the instruction to the receiving bank.

(b) If an instruction complying with subsection (a) (1) of this section is to make more than one payment to a beneficiary, the instruction is a separate payment order with respect to each payment.

(c) A payment order is issued when it is sent to the receiving bank.

Source: L. 90: Entire article added, p. 342, § 1, effective January 1, 1991.

OFFICIAL COMMENT

This section is discussed in the Comment following Section 4A-104.

4-4.5-104. Funds transfer - definitions. In this article:

(a) "Funds transfer" means the series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. The term includes any payment order issued by the originator's bank or an intermediary bank intended to carry out the originator's payment order. A funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order.

(b) "Intermediary bank" means a receiving bank other than the originator's bank or the beneficiary's bank.

(c) "Originator" means the sender of the first payment order in a funds transfer.

(d) "Originator's bank" means (i) the receiving bank to which the payment order of the originator is issued if the originator is not a bank, or (ii) the originator if the originator is a bank.

Source: L. 90: Entire article added, p. 343, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. Article 4A governs a method of payment in which the person making payment (the "originator") directly transmits an instruction to a bank either to make payment to the person receiving payment (the "beneficiary" or to instruct some other bank to make payment to the beneficiary. The payment from the originator to the beneficiary occurs when the bank that is to

pay the beneficiary becomes obligated to pay the beneficiary. There are two basic definitions: "Payment order" stated in Section 4A-103 and "Funds transfer" stated in Section 4A-104. These definitions, other related definitions, and the scope of Article 4A can best be understood in the context of specific fact situations. Consider the following cases:

Case #1. X, which has an account in Bank A, instructs that bank to pay $1,000,000 to Y's account in Bank A. Bank A carries out X's instruction by making a credit of $1,000,000 to Y's account and notifying Y that the credit is available for immediate withdrawal. The instruction by X to Bank A is a "payment order" which was issued when it was sent to Bank A. Section 4A-103(a)(1) and (c). X is the "sender" of the payment order and Bank A is the "receiving bank." Section 4A-103(a)(5) and (a) (4). Y is the "beneficiary" of the payment order and Bank A is the "beneficiary's bank." Section 4A-103(a)(2) and (a) (3). When Bank A notified Y of receipt of the payment order, Bank A "accepted" the payment order. Section 4A-209(b)(1). When Bank A accepted the order it incurred an obligation to Y to pay the amount of the order. Section 4A-404(a). When Bank A accepted X's order, X incurred an obligation to pay Bank A the amount of the order. Section 4A-402(b). Payment from X to Bank A would normally be made by a debit to X's account in Bank A. Section 4A-403(a)(3). At the time Bank A incurred the obligation to pay Y, payment of $1,000,000 by X to Y was also made. Section 4A-406(a). Bank A paid Y when it gave notice to Y of a withdrawable credit of $1,000,000 to Y's account. Section 4A-405(a). The overall transaction, which comprises the acts of X and Bank A, in which the payment by X to Y is accomplished is referred to as the "funds transfer." Section 4A-104(a). In this case only one payment order was involved in the funds transfer. A one-payment-order funds transfer is usually referred to as a "book transfer" because the payment is accomplished by the receiving bank's debiting the account of the sender and crediting the account of the beneficiary in the same bank. X, in addition to being the sender of the payment order to Bank A, is the "originator" of the funds transfer. Section 4A-104(c). Bank A is the "originator's bank" in the funds transfer as well as the beneficiary's bank. Section 4A-104(d).

Case #2. Assume the same facts as in Case #1 except that X instructs Bank A to pay $1,000,000 to Y's account in Bank B. With respect to this payment order, X is the sender, Y is the beneficiary, and Bank A is the receiving bank. Bank A carries out X's order by instructing Bank B to pay $1,000,000 to Y's account. This instruction is a payment order in which Bank A is the sender, Bank B is the receiving bank, and Y is the beneficiary. When Bank A issued its payment order to Bank B, Bank A "executed" X's order. Section 4A-301(a). In the funds transfer, X is the originator, Bank A is the originator's bank, and Bank B is the beneficiary's bank. When Bank A executed X's order, X incurred an obligation to pay Bank A the amount of the order. Section 4A-402(c). When Bank B accepts the payment order issued to it by Bank A, Bank B incurs an obligation to Y to pay the amount of the order (Section 4A-404 (a)) and Bank A incurs an obligation to pay Bank B. Section 4A-402(b). Acceptance by Bank B also results in payment of $1,000,000 by X to Y. Section 4A-406(a). In this case two payment orders are involved in the funds transfer.

Case #3. Assume the same facts as in Case #2 except that Bank A does not execute X's payment order by issuing a payment order to Bank B. One bank will not normally act to carry out a funds transfer for another bank unless there is a preexisting arrangement between the banks for transmittal of payment orders and settlement of accounts. For example, if Bank B is a foreign bank with which Bank A has no relationship, Bank A can utilize a bank that is a correspondent of both Bank A and Bank B. Assume Bank A issues a payment order to Bank C to pay $1,000,000 to Y's account in Bank B. With respect to this order, Bank A is the sender, Bank C is the receiving bank, and Y is the beneficiary. Bank C will execute the payment order of Bank A by issuing a payment order to Bank B to pay $1,000,000 to Y's account in Bank B. With respect to Bank C's payment order, Bank C is the sender, Bank B is the receiving bank, and Y is the beneficiary. Payment of $1,000,000 by X to Y occurs when Bank B accepts the payment order issued to it by Bank C. In this case the funds transfer involves three payment orders. In the funds transfer, X is the originator, Bank A is the originator's bank, Bank B is the beneficiary's bank, and Bank C is an "intermediary bank." Section 4A-104 (b). In some cases there may be more than one intermediary bank, and in those cases each intermediary bank is treated like Bank C in Case #3.

As the three cases demonstrate, a payment under Article 4A involves an overall transaction, the funds transfer, in which the originator, X, is making payment to the beneficiary, Y, but the funds transfer may encompass a series of payment orders that are issued in order to effect the payment initiated by the originator's payment order.

In some cases the originator and the beneficiary may be the same person. This will occur, for example, when a corporation orders a bank to transfer funds from an account of the corporation in that bank to another account of the corporation in that bank or in some other bank. In some funds transfers the first bank to issue a payment order is a bank that is executing a payment order of a customer that is not a bank. In this case the customer is the originator. In

other cases, the first bank to issue a payment order is not acting for a customer, but is making a payment for its own account. In that event the first bank to issue a payment order is the originator as well as the originator's bank.

2. "Payment order" is defined in Section 4A-103(a)(1) as an instruction to a bank to pay, or to cause another bank to pay, a fixed or determinable amount of money. The bank to which the instruction is addressed is known as the "receiving bank." Section 4A-1O3(a)(4). "Bank" is defined in Section 4A-105(a)(2). The effect of this definition is to limit Article 4A to payments made through the banking system. A transfer of funds made by an entity outside the banking system is excluded. A transfer of funds through an entity other than a bank is usually a consumer transaction involving relatively small amounts of money and a single contract carried out by transfers of cash or a cash equivalent such as a check. Typically, the transferor delivers cash or a check to the company making the transfer, which agrees to pay a like amount to a person designated by the transferor. Transactions covered by Article 4A typically involve very large amounts of money in which several transactions involving several banks may be necessary to carry out the payment. Payments are normally made by debits or credits to bank accounts. Originators and beneficiaries are almost always business organizations and the transfers are usually made to pay obligations. Moreover, these transactions are frequently done on the basis of very short-term credit granted by the receiving bank to the sender of the payment order. Wholesale wire transfers involve policy questions that are distinct from those involved in consumer-based transactions by nonbanks.

3. Further limitations on the scope of Article 4A are found in the three requirements found in subparagraphs (i), (ii), and (iii) of Section 4A-103(a)(1). Subparagraph (i) states that the instruction to pay is a payment order only if it "does not state a condition to payment to the beneficiary other than time of payment." An instruction to pay a beneficiary sometimes is subject to a requirement that the beneficiary perform some act such as delivery of documents. For example, a New York bank may have issued a letter of credit in favor of X, a California seller of goods to be shipped to the New York bank's customer in New York. The terms of the letter of credit provide for payment to X if documents are presented to prove shipment of the goods. Instead of providing for presentment of the documents to the New York bank, the letter of credit states that they may be presented to a California bank that acts as an agent for payment. The New York bank sends an instruction to the California bank to pay X upon presentation of the required documents. The instruction is not covered by Article 4A because payment to the beneficiary is conditional upon receipt of shipping documents. The function of banks in a funds transfer under Article 4A is comparable to the role of banks in the collection and payment of checks in that it is essentially mechanical in nature. The low price and high speed that characterize funds transfers reflect this fact. Conditions to payment by the California bank other than time of payment impose responsibilities on that bank that go beyond those in Article 4A funds transfers. Although the payment by the New York bank to X under the letter of credit is not covered by Article 4A, if X is paid by the California bank, payment of the obligation of the New York bank to reimburse the California bank could be made by an Article 4A funds transfer. In such a case there is a distinction between the payment by the New York bank to X under the letter of credit and the payment by the New York bank to the California bank. For example, if the New York bank pays its reimbursement obligation to the California bank by a Fedwire naming the California bank as beneficiary (see Comment 1 to Section 4A-107), payment is made to the California bank rather than to X. That payment is governed by Article 4A and it could be made either before or after payment by the California bank to X. The payment by the New York bank to X under the letter of credit is not governed by Article 4A and it occurs when the California bank, as agent of the New York bank, pays X. No payment order was involved in that transaction. In this example, if the New York bank had erroneously sent an instruction to the California bank unconditionally instructing payment to X, the instruction would have been an Article 4A payment order. If the payment order was accepted (Section 4A-209(b)) by the California bank, a payment by the New York bank to X would have resulted (Section 4A-406(a)). But Article 4A would not prevent recovery of funds from X on the basis that X was not entitled to retain the funds under the law of mistake and restitution, letter of credit law or other applicable law.

4. Transfers of funds made through the banking system are commonly referred to as either "credit" transfers or "debit" transfers. In a credit transfer the instruction to pay is given by the person making payment. In a debit transfer the instruction to pay is given by the person receiving payment. The purpose of subparagraph (ii) of subsection (a) (1) of Section 4A-103 is to include credit transfers in Article 4A and to exclude debit transfers. All of the instructions to pay in the three cases described in Comment 1 fall within subparagraph (ii). Take Case #2 as an example. With respect to X's instruction given to Bank A, Bank A will be reimbursed by debiting X's account or otherwise receiving payment from X. With respect to Bank A's instruction to Bank B, Bank B will be reimbursed by receiving payment from Bank A.

In a debit transfer, a creditor, pursuant to authority from the debtor, is enabled to draw on the debtor's bank account by issuing an instruction to pay to the debtor's bank. If the debtor's bank pays, it will be reimbursed by the debtor rather than by the person giving the instruction. For example, the holder of an insurance policy may pay premiums by authorizing the insurance company to order the policyholder's bank to pay the insurance company. The order to pay may be in the form of a draft covered by Article 3, or it might be an instruction to pay that is not an instrument under that Article. The bank receives reimbursement by debiting the policyholder's account. Or, a subsidiary corporation may make payments to its parent by authorizing the parent to order the subsidiary's bank to pay the parent from the subsidiary's account. These transactions are not covered by Article 4A because subparagraph (2) is not satisfied. Article 4A is limited to transactions in which the account to be debited by the receiving bank is that of the person in whose name the instruction is given.

If the beneficiary of a funds transfer is the originator of the transfer, the transfer is governed by Article 4A if it is a credit transfer in form. If it is in the form of a debit transfer it is not governed by Article 4A. For example, Corporation has accounts in Bank A and Bank B. Corporation instructs Bank A to pay to Corporation's account in Bank B. The funds transfer is governed by Article 4A. Sometimes, Corporation will authorize Bank B to draw on Corporation's account in Bank A for the purpose of transferring funds into Corporation's account in Bank B. If Corporation also makes an agreement with Bank A under which Bank A is authorized to follow instructions of Bank B, as agent of Corporation, to transfer funds from Customer's account in Bank A, the instruction of Bank B is a payment order of Customer and is governed by Article 4A. This kind of transaction is known in the wiretransfer business as a "drawdown transfer." If Corporation does not make such an agreement with Bank A and Bank B instructs Bank A to make the transfer, the order is in form a debit transfer and is not governed by Article 4A. These debit transfers are normally ACH transactions in which Bank A relies on Bank B's warranties pursuant to ACH rules, including the warranty that the transfer is authorized.

5. The principal effect of subparagraph (iii) of subsection (a) of Section 4A-103 is to exclude from Article 4A payments made by check or credit card. In those cases the instruction of the debtor to the bank on which the check is drawn or to which the credit card slip is to be presented is contained in the check or credit card slip signed by the debtor. The instruction is not transmitted by the debtor directly to the debtor's bank. Rather, the instruction is delivered or otherwise transmitted by the debtor to the creditor who then presents it to the bank either directly or through bank collection channels. These payments are governed by Articles 3 and 4 and federal law. There are, however, limited instances in which the paper on which a check is printed can be used as the means of transmitting a payment order that is covered by Article 4A. Assume that Originator instructs Originator's Bank to pay $10,000 to the account of Beneficiary in Beneficiary's Bank. Since the amount of Originator's payment order is small, if Originator's Bank and Beneficiary's Bank do not have an account relationship, Originator's Bank may execute Originator's order by issuing a teller's check payable to Beneficiary's Bank for $10,000 along with instructions to credit Beneficiary's account in that amount. The instruction to Beneficiary's Bank to credit Beneficiary's account is a payment order. The check is the means by which Originator's Bank pays its obligation as sender of the payment order. The instruction of Originator's Bank to Beneficiary's Bank might be given in a letter accompanying the check or it may be written on the check itself. In either case the instruction to Beneficiary's Bank is a payment order but the check itself (which is an order to pay addressed to the drawee rather than to Beneficiary's Bank) is an instrument under Article 3 and is not a payment order. The check can be both the means by which Originator's Bank pays its obligation under § 4A-402(b) to Beneficiary's Bank and the means by which the instruction to Beneficiary's Bank is transmitted.

6. Most payments covered by Article 4A are commonly referred to as wire transfers and usually involve some kind of electronic transmission, but the applicability of Article 4A does not depend upon the means used to transmit the instruction of the sender. Transmission may be by letter or other written communication, oral communication or electronic communication. An oral communication is normally given by telephone. Frequently the message is recorded by the receiving bank to provide evidence of the transaction, but apart from problems of proof there is no need to record the oral instruction. Transmission of an instruction may be a direct communication between the sender and the receiving bank or through an intermediary such as an agent of the sender, a communication system such as international cable, or a funds transfer system such as CHIPS, SWIFT or an automated clearing house.

4-4.5-105. Other definitions. (a) In this article:

(1) "Authorized account" means a deposit account of a customer in a bank designated by the customer as a source of payment of payment orders issued by the customer to the

bank. If a customer does not so designate an account, any account of the customer is an authorized account if payment of a payment order from that account is not inconsistent with a restriction on the use of that account.

(2) "Bank" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, industrial bank, and trust company. A branch or separate office of a bank is a separate bank for purposes of this article.

(3) "Customer" means a person, including a bank, having an account with a bank or from whom a bank has agreed to receive payment orders.

(4) "Funds-transfer business day" of a receiving bank means the part of a day during which the receiving bank is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders.

(5) "Funds-transfer system" means a wire transfer network, automated clearing house, or other communication system of a clearing house or other association of banks through which a payment order by a bank may be transmitted to the bank to which the order is addressed.

(6) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(7) "Prove" with respect to a fact means to meet the burden of establishing the fact (section 4-1-201 (b) (8)).

(b) Other definitions applying to this article and the sections in which they appear are:

"Acceptance".	Section 4-4.5-209
"Beneficiary".	Section 4-4.5-103
"Beneficiary's bank".	Section 4-4.5-103
"Executed".	Section 4-4.5-301
"Execution date".	Section 4-4.5-301
"Funds transfer".	Section 4-4.5-104
"Funds-transfer system rule".	Section 4-4.5-501
"Intermediary bank".	Section 4-4.5-104
"Originator".	Section 4-4.5-104
"Originator's bank".	Section 4-4.5-104
"Payment by beneficiary's bank to beneficiary".	Section 4-4.5-405
"Payment by originator to beneficiary".	Section 4-4.5-406
"Payment by sender to receiving bank".	Section 4-4.5-403
"Payment date".	Section 4-4.5-401
"Payment order".	Section 4-4.5-103
"Receiving bank".	Section 4-4.5-103
"Security procedure".	Section 4-4.5-201
"Sender".	Section 4-4.5-103

(c) The following definitions in article 4 of this title apply to this article:

"Clearing house".	Section 4-4-104
"Item".	Section 4-4-104
"Suspends payments".	Section 4-4-104

(d) In addition, article 1 contains general definitions and principles of construction and interpretation applicable throughout this article.

Source: L. 90: Entire article added, p. 343, § 1, effective January 1, 1991. **L. 2006:** (a)(7) amended, p. 497, § 28, effective September 1.

OFFICIAL COMMENT

1. The definition of "bank" in subsection (a) (2) includes some institutions that are not commercial banks. The definition reflects the fact that many financial institutions now perform functions previously restricted to commercial banks, including acting on behalf of customers in funds transfers. Since many funds transfers involve payment orders to or from foreign countries the definition also covers foreign banks. The definition also includes Federal

Reserve Banks. Funds transfers carried out by Federal Reserve Banks are described in Comments 1 and 2 to Section 4A-107.

2. Funds transfer business is frequently transacted by banks outside of general banking hours. Thus, the definition of banking day in Section 4-104(1)(c) cannot be used to describe when a bank is open for funds transfer business. Subsection (a)(4) defines a new term, "funds transfer business day," which is applicable to Article 4A. The definition states, "is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders." In some cases it is possible to electronically transmit payment orders and other communications to a receiving bank at any time. If the receiving bank is not open for the processing of an order when it is received, the communication is stored in the receiving bank's computer for retrieval when the receiving bank is open for processing. The use of the conjunctive makes clear that the defined term is limited to the period during which all functions of the receiving bank can be performed, i.e., receipt, processing, and transmittal of payment orders, cancellations and amendments.

3. Subsection (a)(5) defines "funds transfer system." The term includes a system such as CHIPS which provides for transmission of a payment order as well as settlement of the obligation of the sender to pay the order. It also includes automated clearing houses, operated by a clearing house or other association of banks, which process and transmit payment orders of banks to other banks. In addition the term includes organizations that provide only transmission services such as SWIFT. The definition also includes the wire transfer network and automated clearing houses of Federal Reserve Banks. Systems of the Federal Reserve Banks, however, are treated differently from systems of other associations of banks. Funds transfer systems other than systems of the Federal Reserve Banks are treated in Article 4A as a means of communication of payment orders between participating banks. Section 4A-2O6. The Comment to that section and the Comment to Section 4A-107 explain how Federal Reserve Banks function under Article 4A. Funds transfer systems are also able to promulgate rules binding on participating banks that, under Section 4A-501, may supplement or in some cases may even override provisions of Article 4A.

4. Subsection (d) incorporates definitions stated in Article I as well as principles of construction and interpretation stated in that Article. Included is Section 1-103. The last paragraph of the Comment to Section 4A-102 is addressed to the issue of the extent to which general principles of law and equity should apply to situations covered by provisions of Article 4A.

4-4.5-106. Time payment order is received. (a) The time of receipt of a payment order or communication cancelling or amending a payment order is determined by the rules applicable to receipt of a notice stated in section 4-1-202. A receiving bank may fix a cut-off time or times on a funds-transfer business day for the receipt and processing of payment orders and communications cancelling or amending payment orders. Different cut-off times may apply to payment orders, cancellations, or amendments, or to different categories of payment orders, cancellations, or amendments. A cut-off time may apply to senders generally or different cut-off times may apply to different senders or categories of payment orders. If a payment order or communication cancelling or amending a payment order is received after the close of a funds-transfer business day or after the appropriate cut-off time on a funds-transfer business day, the receiving bank may treat the payment order or communication as received at the opening of the next funds-transfer business day.

(b) If this article refers to an execution date or payment date or states a day on which a receiving bank is required to take action, and the date or day does not fall on a funds-transfer business day, the next day that is a funds-transfer business day is treated as the date or day stated, unless the contrary is stated in this article.

Source: L. 90: Entire article added, p. 344, § 1, effective January 1, 1991. **L. 2006:** (a) amended, p. 497, § 29, effective September 1.

OFFICIAL COMMENT

The time that a payment order is received by a receiving bank usually defines the payment date or the execution date of a payment order. Section 4A-401 and Section 4A-301. The time of receipt of a payment order, or communication cancelling or amending a payment order is defined in subsection (a) by reference to the rules stated in Section 1-201(27). Thus, time of re-

ceipt is determined by the same rules that determine when a notice is received. Time of receipt, however, may be altered by a cut-off time.

4-4.5-107. Federal reserve regulations and operating circulars. Regulations of the board of governors of the federal reserve system and operating circulars of the federal reserve banks supersede any inconsistent provision of this article to the extent of the inconsistency.

Source: L. 90: Entire article added, p. 345, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. Funds transfers under Article 4A may be made, in whole or in part, by payment orders through a Federal Reserve Bank in what is usually referred to as a transfer by Fedwire. If Bank A, which has an account in Federal Reserve Bank X, wants to pay $1,000,000 to Bank B, which has an account in Federal Reserve Bank Y, Bank A can issue an instruction to Reserve Bank X requesting a debit of $1,000,000 to Bank A's Reserve account and an equal credit to Bank B's Reserve account. Reserve Bank X will debit Bank A's account and will credit the account of Reserve Bank Y. Reserve Bank X will issue an instruction to Reserve Bank Y requesting a debit of $1,000,000 to the account of Reserve Bank X and an equal "credit" to Bank B's account in Reserve Bank Y. Reserve Bank Y will make the requested debit and credit and will give Bank B an advice of credit. The definition of "bank" in Section 4A-105(a)(2) includes both Reserve Bank X and Reserve Bank Y. Bank A's instruction to Reserve Bank X to pay money to Bank B is a payment order under Section 4A-103(a)(1). Bank A is the sender and Reserve Bank X is the receiving bank. Bank B is the beneficiary of Bank A's order and of the funds transfer. Bank A is the originator of the funds transfer and is also the originator's bank. Section 4A-104(c) and (d). Reserve Bank X, an intermediary bank under Section 4A-104(b), executes Bank A's order by sending a payment order to Reserve Bank Y instructing that bank to credit the Federal Reserve account of Bank B. Reserve Bank Y is the beneficiary's bank.

Suppose the transfer of funds from Bank A to Bank B is part of a larger transaction in which Originator, a customer of Bank A, wants to pay Beneficiary, a customer of Bank B. Originator issues a payment order to Bank A to pay $1,000,000 to the account of Beneficiary in Bank B. Bank A may execute Originator's order by means of Fedwire which simultaneously transfers $1,000,000 from Bank A to Bank B and carries a message instructing Bank B to pay $1,000,000 to the account of Y. The Fedwire transfer is carried out as described in the previous paragraph, except that the beneficiary of the funds transfer is Beneficiary rather than Bank B. Reserve Bank X and Reserve Bank Y are intermediary banks. When Reserve Bank Y advises Bank B of the credit to its Federal Reserve account it will also instruct Bank B to pay to the account of Beneficiary. The instruction is a payment order to Bank B which is the beneficiary's bank. When Reserve Bank Y advises Bank B of the credit to its Federal Reserve account Bank B receives payment of the payment order issued to it by Reserve Bank Y. Section 4A-403(a)(1). The payment order is automatically accepted by Bank B at the time it receives the payment order of Reserve Bank Y. Section 4A-209(b)(2). At the time of acceptance by Bank B payment by Originator to Beneficiary also occurs. Thus, in a Fedwire transfer, payment to the beneficiary's bank, acceptance by the beneficiary's bank and payment by the originator to the beneficiary all occur simultaneously by operation of law at the time the payment order to the beneficiary's bank is received.

If Originator orders payment to the account of Beneficiary in Bank C rather than Bank B, the analysis is somewhat modified. Bank A may not have any relationship with Bank C and may not be able to make payment directly to Bank C. In that case, Bank A could send a Fedwire instructing Bank B to instruct Bank C to pay Beneficiary. The analysis is the same as the previous case except that Bank B is an intermediary bank and Bank C is the beneficiary's bank.

2. A funds transfer can also be made through a Federal Reserve Bank in an automated clearing house transaction. In a typical case, Originator instructs Originator's Bank to pay to the account of Beneficiary in Beneficiary's Bank. Originator's instruction to pay a particular beneficiary is transmitted to Originator's Bank along with many other instructions for payment to other beneficiaries by many different beneficiary's banks. All of these instructions are contained in a magnetic tape or other electronic device. Transmission of instructions to the various beneficiary's banks requires that Originator's instructions be processed and repackaged with instructions of other originators so that all instructions to a particular beneficiary's bank

are transmitted together to that bank. The repackaging is done in processing centers usually referred to as automated clearing houses. Automated clearing houses are operated either by Federal Reserve Banks or by other associations of banks. If Originator's Bank chooses to execute Originator's instructions by transmitting them to a Federal Reserve Bank for processing by the Federal Reserve Bank, the transmission to the Federal Reserve Bank results in the issuance of payment orders by Originator's Bank to the Federal Reserve Bank, which is an intermediary bank. Processing by the Federal Reserve Bank will result in the issuance of payment orders by the Federal Reserve Bank to Beneficiary's Bank as well as payment orders to other beneficiary's banks making payments to carry out Originator's instructions.

3. Although the terms of Article 4A apply to funds transfers involving Federal Reserve Banks, federal preemption would make ineffective any Article 4A provision that conflicts with federal law. The payments activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 4A-107 states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 4A to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. Childs v. Federal Reserve Bank of Dallas, 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984) Section 4A-107 treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation.

4-4.5-108. Exclusion of consumer transactions governed by federal law. This article does not apply to a funds transfer any part of which is governed by the "Electronic Fund Transfer Act of 1978" (Title XX, Public Law 95-630, 92 Stat. 3728, 15 U.S.C. Section 1693 et seq.) as amended from time to time.

Source: L. 90: Entire article added, p. 345, § 1, effective January 1, 1991.

OFFICIAL COMMENT

The Electronic Fund Transfer Act of 1978 is a federal statute that covers a wide variety of electronic funds transfers involving consumers. The types of transfers covered by the federal statute are essentially different from the wholesale wire transfers that are the primary focus of Article 4A. Section 4A-108 excludes a funds transfer from Article 4A if any part of the transfer is covered by the federal law. Existing procedures designed to comply with federal law will not be affected by Article 4A. The effect of Section 4A-108 is to make Article 4A and EFTA mutually exclusive. For example, if a funds transfer is to a consumer account in the beneficiary's bank and the funds transfer is made in part by use of Fedwire and in part by means of an automated clearing house, EFTA applies to the ACH part of the transfer but not to the Fedwire part. Under Section 4A-108, Article 4A does not apply to any part of the transfer. However, in the absence of any law to govern the part of the funds transfer that is not subject to EFTA, a court might apply appropriate principles from Article 4A by analogy.

PART 2

ISSUE AND ACCEPTANCE OF PAYMENT ORDER

4-4.5-201. Security procedure. "Security procedure" means a procedure established by agreement of a customer and a receiving bank for the purpose of (i) verifying that a payment order or communication amending or cancelling a payment order is that of the customer, or (ii) detecting error in the transmission or the content of the payment order or communication. A security procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures, or similar security devices. Comparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure.

Source: L. 90: Entire article added, p. 345, § 1, effective January 1, 1991.

OFFICIAL COMMENT

A large percentage of payment orders and communications amending or cancelling payment orders are transmitted electronically and it is standard practice to use security procedures that are designed to assure the authenticity of the message. Security procedures can also be used to detect error in the content of messages or to detect payment orders that are transmitted by mistake as in the case of multiple transmission of the same payment order. Security procedures might also apply to communications that are transmitted by telephone or in writing. Section 4A-201 defines these security procedures. The definition of security procedure limits the term to a procedure "established by agreement of a customer and a receiving bank." The term does not apply to procedures that the receiving bank may follow unilaterally in processing payment orders. The question of whether loss that may result from the transmission of a spurious or erroneous payment order will be borne by the receiving bank or the sender or purported sender is affected by whether a security procedure was or was not in effect and whether there was or was not compliance with the procedure. Security procedures are referred to in Sections 4A-202 and 4A-203, which deal with authorized and verified payment orders, and Section 4A-205, which deals with erroneous payment orders.

4-4.5-202. Authorized and verified payment orders. (a) A payment order received by the receiving bank is the authorized order of the person identified as sender if that person authorized the order or is otherwise bound by it under the law of agency.

(b) If a bank and its customer have agreed that the authenticity of payment orders issued to the bank in the name of the customer as sender will be verified pursuant to a security procedure, a payment order received by the receiving bank is effective as the order of the customer, whether or not authorized, if (i) the security procedure is a commercially reasonable method of providing security against unauthorized payment orders, and (ii) the bank proves that it accepted the payment order in good faith and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer. The bank is not required to follow an instruction that violates a written agreement with the customer or notice of which is not received at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted.

(c) Commercial reasonableness of a security procedure is a question of law to be determined by considering the wishes of the customer expressed to the bank, the circumstances of the customer known to the bank, including the size, type, and frequency of payment orders normally issued by the customer to the bank, alternative security procedures offered to the customer, and security procedures in general use by customers and receiving banks similarly situated. A security procedure is deemed to be commercially reasonable if (i) the security procedure was chosen by the customer after the bank offered, and the customer refused, a security procedure that was commercially reasonable for that customer, and (ii) the customer expressly agreed in writing to be bound by any payment order, whether or not authorized, issued in its name and accepted by the bank in compliance with the security procedure chosen by the customer.

(d) The term "sender" in this article includes the customer in whose name a payment order is issued if the order is the authorized order of the customer under subsection (a) of this section, or it is effective as the order of the customer under subsection (b) of this section.

(e) This section applies to amendments and cancellations of payment orders to the same extent it applies to payment orders.

(f) Except as provided in this section and in section 4-4.5-203 (a) (1), rights and obligations arising under this section or section 4-4.5-203 may not be varied by agreement.

Source: L. 90: Entire article added, p. 345, § 1, effective January 1, 1991.

OFFICIAL COMMENT

This section is discussed in the Comment following Section 4A-203.

4-4.5-203. Unenforceability of certain verified payment orders. (a) If an accepted payment order is not, under section 4-4.5-202 (a), an authorized order of a customer identified as sender, but is effective as an order of the customer pursuant to section 4-4.5-202 (b), the following rules apply:

(1) By express written agreement, the receiving bank may limit the extent to which it is entitled to enforce or retain payment of the payment order.

(2) The receiving bank is not entitled to enforce or retain payment of the payment order if the customer proves that the order was not caused, directly or indirectly, by a person (i) entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure, or (ii) who obtained access to transmitting facilities of the customer or who obtained, from a source controlled by the customer and without authority of the receiving bank, information facilitating breach of the security procedure, regardless of how the information was obtained or whether the customer was at fault. Information includes any access device, computer software, or the like.

(b) This section applies to amendments of payment orders to the same extent it applies to payment orders.

Source: L. 90: Entire article added, p. 346, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. Some person will always be identified as the sender of a payment order. Acceptance of the order by the receiving bank is based on a belief by the bank that the order was authorized by the person identified as the sender. If the receiving bank is the beneficiary's bank acceptance means that the receiving bank is obliged to pay the beneficiary. If the receiving bank is not the beneficiary's bank, acceptance means that the receiving bank has executed the sender's order and is obliged to pay the bank that accepted the order issued in execution of the sender's order. In either case the receiving bank may suffer a loss unless it is entitled to enforce payment of the payment order that it accepted. If the person identified as the sender of the order refuses to pay on the ground that the order was not authorized by that person, what are the rights of the receiving bank? In the absence of a statute or agreement that specifically addresses the issue, the question usually will be resolved by the law of agency. In some cases, the law of agency works well. For example, suppose the receiving bank executes a payment order given by means of a letter apparently written by a corporation that is a customer of the bank and apparently signed by an officer of the corporation. If the receiving bank acts solely on the basis of the letter, the corporation is not bound as the sender of the payment order unless the signature was that of the officer and the officer was authorized to act for the corporation in the issuance of payment orders, or some other agency doctrine such as apparent authority or estoppel causes the corporation to be bound. Estoppel can be illustrated by the following example. Suppose P is aware that A, who is unauthorized to act for P, has fraudulently misrepresented to T that A is authorized to act for P. T believes A and is about to rely on the misrepresentation. If P does not notify T of the true facts although P could easily do so, P may be estopped from denying A's lack of authority. A similar result could follow if the failure to notify T is the result of negligence rather than a deliberate decision. Restatement, Second, Agency § 8B. Other equitable principles such as subrogation or restitution might also allow a receiving bank to recover with respect to an unauthorized payment order that it accepted. In Gatoil (U.S.A.), Inc. v. Forest Hill State Bank, 1 U.C.C. Rep. Serv. 2d 171 (D.Md. 1986), a joint venturer not authorized to order payments from the account of the joint venture, ordered a funds transfer from the account. The transfer paid a bona fide debt of the joint venture. Although the transfer was unauthorized the court refused to require recredit of the account because the joint venture suffered no loss. The result can be rationalized on the basis of subrogation of the receiving bank to the right of the beneficiary of the funds transfer to receive the payment from the joint venture.

But in most cases these legal principles give the receiving bank very little protection in the case of an authorized payment order. Cases like those just discussed are not typical of the way that most payment orders are transmitted and accepted, and such cases are likely to become even less common. Given the large amount of the typical payment order, a prudent receiving bank will be unwilling to accept a payment order unless it has assurance that the order is what it purports to be. This assurance is normally provided by security procedures described in Section 4A-201.

In a very large percentage of cases covered by Article 4A, transmission of the payment order is made electronically. The receiving bank may be

required to act on the basis of a message that appears on a computer screen. Common law concepts of authority of agent to bind principal are not helpful. There is no way of determining the identity or the authority of the person who caused the message to be sent. The receiving bank is not relying on the authority of any particular person to act for the purported sender. The case is not comparable to payment of a check by the drawee bank on the basis of a signature that is forged. Rather, the receiving bank relies on a security procedure pursuant to which the authenticity of the message can be "tested" by various devices which are designed to provide certainty that the message is that of the sender identified in the payment order. In the wire transfer business the concept of "authorized" is different from that found in agency law. In that business a payment order is treated as the order of the person in whose name it is issued if it is properly tested pursuant to a security procedure and the order passes the test.

Section 4A-202 reflects the reality of the wire transfer business. A person in whose name a payment order is issued is considered to be the sender of the order if the order is "authorized" as stated in subsection (a) or if the order is "verified" pursuant to a security procedure in compliance with subsection (b). If subsection (b) does not apply, the question of whether the customer is responsible for the order is determined by the law of agency. The issue is one of actual or apparent authority of the person who caused the order to be issued in the name of the customer. In some cases the law of agency might allow the customer to be bound by an unauthorized order if conduct of the customer can be used to find an estoppel against the customer to deny that the order was unauthorized. If the customer is bound by the order under any of these agency doctrines, subsection (a) treats the order as authorized and thus the customer is deemed to be the sender of the order. In most cases, however, subsection (b) will apply. In that event there is no need to make an agency law analysis to determine authority. Under Section 4A-202, the issue of liability of the purported sender of the payment order will be determined by agency law only if the receiving bank did not comply with subsection (b).

2. The scope of Section 4A-202 can be illustrated by the following cases. **Case #1**. A payment order purporting to be that of Customer is received by Receiving Bank but the order was fraudulently transmitted by a person who had no authority to act for Customer. **Case #2**. An authentic payment order was sent by Customer, but before the order was received by Receiving Bank the order was fraudulently altered by an unauthorized person to change the beneficiary. **Case #3**. An authentic payment order was received by Receiving Bank, but before the order was executed by Receiving Bank a person who had no authority to act for Customer fraudulently sent a communication purporting to amend the order by changing the beneficiary. In each case Receiving Bank acted on the fraudulent communication by accepting the payment order. These cases are all essentially similar and they are treated identically by Section 4A-202. In each case Receiving Bank acted on a communication that it thought was authorized by Customer when in fact the communication was fraudulent. No distinction is made between Case #1 in which Customer took no part at all in the transaction and Case #2 and Case #3 in which an authentic order was fraudulently altered or amended by an unauthorized person. If subsection (b) does not apply. each case is governed by subsection (a). If there are no additional facts on which an estoppel might be found, Customer is not responsible in Case #1 for the fraudulently issued payment order, in Case #2 for the fraudulent alteration or in Case #3 for the fraudulent amendment. Thus, in each case Customer is not liable to pay the order and Receiving Bank takes the loss. The only remedy of Receiving Bank is to seek recovery from the person who received payment as beneficiary of the fraudulent order. If there was verification in compliance with subsection (b), Customer will take the loss unless Section 4A-203 applies.

3. Subsection (b) of Section 4A-202 is based on the assumption that losses due to fraudulent payment orders can best be avoided by the use of commercially reasonable security procedures, and that the use of such procedures should be encouraged. The subsection is designed to protect both the customer and the receiving bank. A receiving bank needs to be able to rely on objective criteria to determine whether it can safely act on a payment order. Employees of the bank can be trained to "test" a payment order according to the various steps specified in the security procedure. The bank is responsible for the acts of these employees. Subsection (b)(ii) requires the bank to prove that it accepted the payment order in good faith and "in compliance with the security procedure." If the fraud was not detected because the bank's employee did not perform the acts required by the security procedure, the bank has not complied. Subsection (b)(ii) also requires the bank to prove that it complied with any agreement or instruction that restricts acceptance of payment orders issued in the name of the customer. A customer may want to protect itself by imposing limitations on acceptance of payment orders by the bank. For example, the customer may prohibit the bank from accepting a payment order that is not payable from an authorized account, that exceeds the credit balance in specified accounts of the customer, or that exceeds some other amount. Another limitation may relate to the beneficiary. The customer may provide the bank with a list of authorized beneficiaries and

prohibit acceptance of any payment order to a beneficiary not appearing on the list. Such limitations may be incorporated into the security procedure itself or they may be covered by a separate agreement or instruction. In either case, the bank must comply with the limitations if the conditions stated in subsection (b) are met. Normally limitations on acceptance would be incorporated into an agreement between the customer and the receiving bank, but in some cases the instruction might be unilaterally given by the customer. If standing instructions or an agreement state limitations on the ability of the receiving bank to act, provision must be made for later modification of the limitations. Normally this would be done by an agreement that specifies particular procedures to be followed. Thus, subsection (b) states that the receiving bank is not required to follow an instruction that violates a written agreement. The receiving bank is not bound by an instruction unless it has adequate notice of it. Subsections (25), (26) and (27) of Section 1-201 apply.

Subsection (b)(i) assures that the interests of the customer will be protected by providing an incentive to a bank to make available to the customer a security procedure that is commercially reasonable. If a commercially reasonable security procedure is not made available to the customer, subsection (b) does not apply. The result is that subsection (a) applies and the bank acts at its peril in accepting a payment order that may be unauthorized. Prudent banking practice may require that security procedures be utilized in virtually all cases except for those in which personal contact between the customer and the bank eliminates the possibility of an unauthorized order. The burden of making available commercially reasonable security procedures is imposed on receiving banks because they generally determine what security procedures can be used and are in the best position to evaluate the efficacy of procedures offered to customers to combat fraud. The burden on the customer is to supervise its employees to assure compliance with the security procedure and to safeguard confidential security information and access to transmitting facilities so that the security procedure cannot be breached.

4. The principal issue that is likely to arise in litigation involving subsection (b) is whether the security procedure in effect when a fraudulent payment order was accepted was commercially reasonable. The concept of what is commercially reasonable in a given case is flexible. Verification entails labor and equipment costs that can vary greatly depending upon the degree of security that is sought. A customer that transmits very large numbers of payment orders in very large amounts may desire and may reasonably expect to be provided with state-of-the-art procedures that provide maximum security. But the expense involved may make use of a state-of-the-art procedure infeasible for a customer that normally transmits payments orders infrequently or in relatively low amounts. Another variable is the type of receiving bank. It is reasonable to require large money center banks to make available state-of-the-art security procedures. On the other hand, the same requirement may not be reasonable for a small country bank. A receiving bank might have several security procedures that are designed to meet the varying needs of different customers. The type of payment order is another variable. For example, in a wholesale wire transfer, each payment order is normally transmitted electronically and individually. A testing procedure will be individually applied to each payment order. In funds transfers to be made by means of an automated clearing house many payment orders are incorporated into an electronic device such as a magnetic tape that is physically delivered. Testing of the individual payment orders is not feasible. Thus, a different kind of security procedure must be adopted to take into account the different mode of transmission.

The issue of whether a particular security procedure is commercially reasonable is a question of law. Whether the receiving bank complied with the procedure is a question of fact. It is appropriate to make the finding concerning commercial reasonability a matter of law because security procedures are likely to be standardized in the banking industry and a question of law standard leads to more predictability concerning the level of security that a bank must offer to its customers. The purpose of subsection (b) is to encourage banks to institute reasonable safeguards against fraud but not to make them insurers against fraud. A security procedure is not commercially unreasonable simply because another procedure might have been better or because the judge deciding the question would have opted for a more stringent procedure. The standard is not whether the security procedure is the best available. Rather it is whether the procedure is reasonable for the particular customer and the particular bank, which is a lower standard. On the other hand, a security procedure that fails to meet prevailing standards of good banking practice applicable to the particular bank should not be held to be commercially reasonable. Subsection (c) states factors to be considered by the judge in making the determination of commercial reasonableness. Sometimes an informed customer refuses a security procedure that is commercially reasonable and suitable for that customer and insists on using a higher-risk procedure because it is more convenient or cheaper. In that case, under the last sentence of subsection (c), the customer has voluntarily assumed the risk of failure of the procedure and cannot shift the loss to the bank. But this result follows only if the customer expressly agrees in writing to assume that risk. It

is implicit in the last sentence of subsection (c) that a bank that accedes to the wishes of its customer in this regard is not acting in bad faith by so doing so long as the customer is made aware of the risk. In all cases, however, a receiving bank cannot get the benefit of subsection (b) unless it has made available to the customer a security procedure that is commercially reasonable and suitable for use by that customer. In most cases, the mutual interest of bank and customer to protect against fraud should lead to agreement to a security procedure which is commercially reasonable.

5. The effect of Section 4A-202(b) is to place the risk of loss on the customer if an unauthorized payment order is accepted by the receiving bank after verification by the bank in compliance with a commercially reasonable security procedure. An exception to this result is provided by Section 4A-203(a)(2). The customer may avoid the loss resulting from such a payment order if the customer can prove that the fraud was not committed by a person described in that subsection. Breach of a commercially reasonable security procedure requires that the person committing the fraud have knowledge of how the procedure works and knowledge of codes, identifying devices, and the like. That person may also need access to transmitting facilities through an access device or other software in order to breach the security procedure. This confidential information must be obtained either from a source controlled by the customer or from a source controlled by the receiving bank. If the customer can prove that the person committing the fraud did not obtain the confidential information from an agent or former agent of the customer or from a source controlled by the customer, the loss is shifted to the bank. "Prove" is defined in Section 4A-105(a)(7). Because of bank regulation requirements, in this kind of case there will always be a criminal investigation as well as an internal investigation of the bank to determine the probable explanation for the breach of security. Because a funds transfer fraud usually will involve a very large amount of money, both the criminal investigation and the internal investigation are likely to be thorough. In some cases there may be an investigation by bank examiners as well. Frequently, these investigations will develop evidence of who is at fault and the cause of the loss. The customer will have access to evidence developed in these investigations and that evidence can be used by the customer in meeting its burden of proof.

6. The effect of Section 4A-202(b) may also be changed by an agreement meeting the requirements of Section 4A-203(a)(1). Some customers may be unwilling to take all or part of the risk of loss with respect to unauthorized payment orders even if all of the requirements of Section 4A-202(b) are met. By virtue of Section 4A-203(a)(1), a receiving bank may assume all of the risk of loss with respect to unauthorized payment orders or the customer and bank may agree that losses from unauthorized payment orders are to be divided as provided in the agreement.

7. In a large majority of cases the sender of a payment order is a bank. In many cases in which there is a bank sender, both the sender and the receiving bank will be members of a funds transfer system over which the payment order is transmitted. Since Section 4A-202(f) does not prohibit a funds transfer system rule from varying rights and obligations under Section 4A-202, a rule of the funds transfer system can determine how loss due to an unauthorized payment order from a participating bank to another participating bank is to be allocated. A funds transfer system rule, however, cannot change the rights of a customer that is not a participating bank. § 4A-501(b). Section 4A-202(f) also prevents variation by agreement except to the extent stated.

4-4.5-204. Refund of payment and duty of customer to report with respect to unauthorized payment order. (a) If a receiving bank accepts a payment order issued in the name of its customer as sender which is (i) not authorized and not effective as the order of the customer under section 4-4.5-202, or (ii) not enforceable, in whole or in part, against the customer under section 4-4.5-203, the bank shall refund any payment of the payment order received from the customer to the extent the bank is not entitled to enforce payment and shall pay interest on the refundable amount calculated from the date the bank received payment to the date of the refund. However, the customer is not entitled to interest from the bank on the amount to be refunded if the customer fails to exercise ordinary care to determine that the order was not authorized by the customer and to notify the bank of the relevant facts within a reasonable time not exceeding ninety days after the date the customer received notification from the bank that the order was accepted or that the customer's account was debited with respect to the order. The bank is not entitled to any recovery from the customer on account of a failure by the customer to give notification as stated in this section.

(b) Reasonable time under subsection (a) of this section may be fixed by agreement as stated in section 4-1-205, but the obligation of a receiving bank to refund payment as stated in subsection (a) of this section may not otherwise be varied by agreement.

Source: L. 90: Entire article added, p. 346, § 1, effective January 1, 1991. **L. 2006:** (b) amended, p. 497, § 30, effective September 1.

OFFICIAL COMMENT

1. With respect to unauthorized payment orders, in a very large percentage of cases a commercially reasonable security procedure will be in effect. Section 4A-204 applies only to cases in which (i) no commercially reasonable security procedure is in effect, (ii) the bank did not comply with a commercially reasonable security procedure that was in effect, (iii) the sender can prove, pursuant to Section 4A-203(a)(2). that the culprit did not obtain confidential security information controlled by the customer, or (iv) the bank, pursuant to Section 4A-203(a) (1) agreed to take all or part of the loss resulting from an unauthorized payment order. In each of these cases the bank takes the risk of loss with respect to an unauthorized payment order because the bank is not entitled to payment from the customer with respect to the order. The bank normally debits the customer's account or otherwise receives payment from the customer shortly after acceptance of the payment order. Subsection (a) of Section 4A-204 states that the bank must recredit the account or refund payment to the extent the bank is not entitled to enforce payment.

2. Section 4A-204 is designed to encourage a customer to promptly notify the receiving bank that it has accepted an unauthorized payment order. Since cases of unauthorized payment orders will almost always involve fraud, the bank's remedy is normally to recover from the beneficiary of the unauthorized order if the beneficiary was party to the fraud. This remedy may not be worth very much and it may not make any difference whether or not the bank promptly learns about the fraud. But in some cases prompt notification may make it easier for the bank to recover some part of its loss from the culprit. The customer will routinely be notified of the debit to its account with respect to an unauthorized order or will otherwise be notified of acceptance of the order. The customer has a duty to exercise ordinary care to determine that the order was unauthorized after it has received notification from the bank, and to advise the bank of the relevant facts within a reasonable time not exceeding 90 days after receipt of notification. Reasonable time is not defined and it may depend on the facts of the particular case. If a payment order for $1,000,000 is wholly unauthorized, the customer should normally discover it in far less than 90 days. If a $1,000,000 payment order was authorized but the name of the beneficiary was fraudulently changed, a much longer period may be necessary to discover the fraud. But in any event, if the customer delays more than 90 days the customer's duty has not been met. The only consequence of a failure of the customer to perform this duty is a loss of interest on the refund payable by the bank. A customer that acts promptly is entitled to interest from the time the customer's account was debited or the customer otherwise made payment. The rate of interest is stated in Section 4A-506. If the customer fails to perform the duty, no interest is recoverable for any part of the period before the bank learns that it accepted an unauthorized order. But the bank is not entitled to any recovery from the customer based on negligence for failure to inform the bank. Loss of interest is in the nature of a penalty on the customer designed to provide an incentive for the customer to police its account. There is no intention to impose a duty on the customer that might result in shifting loss from the unauthorized order to the customer.

4-4.5-205. Erroneous payment orders. (a) If an accepted payment order was transmitted pursuant to a security procedure for the detection of error and the payment order (i) erroneously instructed payment to a beneficiary not intended by the sender, (ii) erroneously instructed payment in an amount greater than the amount intended by the sender, or (iii) was an erroneously transmitted duplicate of a payment order previously sent by the sender, the following rules apply:

(1) If the sender proves that the sender or a person acting on behalf of the sender pursuant to section 4-4.5-206 complied with the security procedure and that the error would have been detected if the receiving bank had also complied, the sender is not obliged to pay the order to the extent stated in paragraphs (2) and (3) of this subsection (a).

(2) If the funds transfer is completed on the basis of an erroneous payment order described in clause (i) or (iii) of subsection (a) of this section, the sender is not obliged to

pay the order and the receiving bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(3) If the funds transfer is completed on the basis of a payment order described in clause (ii) of subsection (a) of this section, the sender is not obliged to pay the order to the extent the amount received by the beneficiary is greater than the amount intended by the sender. In that case, the receiving bank is entitled to recover from the beneficiary the excess amount received to the extent allowed by the law governing mistake and restitution.

(b) If (i) the sender of an erroneous payment order described in subsection (a) of this section is not obliged to pay all or part of the order, and (ii) the sender receives notification from the receiving bank that the order was accepted by the bank or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care, on the basis of information available to the sender, to discover the error with respect to the order and to advise the bank of the relevant facts within a reasonable time, not exceeding ninety days, after the bank's notification was received by the sender. If the bank proves that the sender failed to perform that duty, the sender is liable to the bank for the loss the bank proves it incurred as a result of the failure, but the liability of the sender may not exceed the amount of the sender's order.

(c) This section applies to amendments to payment orders to the same extent it applies to payment orders.

Source: L. 90: Entire article added, p. 347, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. This section concerns error in the content or in the transmission of payment orders. It deals with three kinds of error. **Case #1**. The order identifies a beneficiary not intended by the sender. For example, Sender intends to wire funds to a beneficiary identified only by an account number. The wrong account number is stated in the order. **Case #2**. The error is in the amount of the order. For example, Sender intends to wire $1,000 to Beneficiary. Through error, the payment order instructs payment of $1,000,000. **Case #3**. A payment order is sent to the receiving bank and then, by mistake, the same payment order is sent to the receiving bank again. In Case #3, the receiving bank may have no way of knowing whether the second order is a duplicate of the first or is another order. Similarly, in Case #1 and Case #2, the receiving bank may have no way of knowing that the error exists. In each case, if this section does not apply and the funds transfer is completed, Sender is obliged to pay the order. Section 4A-402. Sender's remedy, based on payment by mistake, is to recover from the beneficiary that received payment.

Sometimes, however, transmission of payment orders of the sender to the receiving bank is made pursuant to a security procedure designed to detect one or more of the errors described above. Since "security procedure" is defined by Section 4A-201 as "a procedure established by agreement of a customer and a receiving bank for the purpose of * * * detecting error * * *," Section 4A-205 does not apply if the receiving bank and the customer did not agree to the establishment of a procedure for detecting error. A security procedure may be designed to detect an account number that is not one to which Sender normally makes payment. In that case, the security procedure may require a special verification that payment to the stated account number was intended. In the case of dollar amounts, the security procedure may require different codes for different dollar amounts. If a $1,000,000 payment order contains a code that is inappropriate for that amount, the error in amount should be detected. In the case of duplicate orders, the security procedure may require that each payment order be identified by a number or code that applies to no other order. If the number or code of each payment order received is registered in a computer base, the receiving bank can quickly identify a duplicate order. The three cases covered by this section are essentially similar. In each, if the error is not detected, some beneficiary will receive funds that the beneficiary was not intended to receive. If this section applies, the risk of loss with respect to the error of the sender is shifted to the bank which has the burden of recovering the funds from the beneficiary. The risk of loss is shifted to the bank only if the sender proves that the error would have been detected if there had been compliance with the procedure and that the sender (or an agent under Section 4A-206) complied. In the case of a duplicate order or a wrong beneficiary, the sender doesn't have to pay the order. In the case of an overpayment, the sender does not have to pay the order to the extent of the overpayment. If subsection (a) (1) applies, the position of the receiving bank is comparable to that of a receiv-

ing bank that erroneously executes a payment order as stated in Section 4A-303. However, failure of the sender to timely report the error is covered by Section 4A-205(b) rather than by Section 4A-304 which applies only to erroneous execution under Section 4A-303. A receiving bank to which the risk of loss is shifted by subsection (a) (1) or (2) is entitled to recover the amount erroneously paid to the beneficiary to the extent allowed by the law of mistake and restitution. Rights of the receiving bank against the beneficiary are similar to those of a receiving bank that erroneously executes a payment order as stated in Section 4A-303. Those rights are discussed in Comment 2 to Section 4A-303.

2. A security procedure established for the purpose of detecting error is not effective unless both sender and receiving bank comply with the procedure. Thus, the bank undertakes a duty of complying with the procedure for the benefit of the sender. This duty is recognized in subsection (a) (1). The loss with respect to the sender's error is shifted to the bank if the bank fails to comply with the procedure and the sender (or an agent under Section 4A-206) does comply. Although the customer may have been negligent in transmitting the erroneous payment order, the loss is put on the bank on a last-clear-chance theory. A similar analysis applies to subsection (b). If the loss with respect to an error is shifted to the receiving bank and the sender is notified by the bank that the erroneous payment order was accepted, the sender has a duty to exercise ordinary care to discover the error and notify the bank of the relevant facts within a reasonable time not exceeding 90 days. If the bank can prove that the sender failed in this duty it is entitled to compensation for the loss incurred as a result of the failure. Whether the bank is entitled to recover from the sender depends upon whether the failure to give timely notice would have made any difference. If the bank could not have recovered from the beneficiary that received payment under the erroneous payment order even if timely notice had been given, the sender's failure to notify did not cause any loss of the bank.

3. Section 4A-205 is subject to variation by agreement under Section 4A-501. Thus, if a receiving bank and its customer have agreed to a security procedure for detection of error, the liability of the receiving bank for failing to detect an error of the customer as provided in Section 4A-205 may be varied as provided in an agreement of the bank and the customer.

4-4.5-206. Transmission of payment order through funds-transfer or other communication system. (a) If a payment order addressed to a receiving bank is transmitted to a funds-transfer system or other third-party communication system for transmittal to the bank, the system is deemed to be an agent of the sender for the purpose of transmitting the payment order to the bank. If there is a discrepancy between the terms of the payment order transmitted to the system and the terms of the payment order transmitted by the system to the bank, the terms of the payment order of the sender are those transmitted by the system. This section does not apply to a funds-transfer system of the federal reserve banks.

(b) This section applies to cancellations and amendments of payment orders to the same extent it applies to payment orders.

Source: L. 90: Entire article added, p. 348, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. A payment order may be issued to a receiving bank directly by delivery of a writing or electronic device or by an oral or electronic communication. If an agent of the sender is employed to transmit orders on behalf of the sender, the sender is bound by the order transmitted by the agent on the basis of agency law. Section 4A-206 is an application of that principle to cases in which a funds transfer or communication system acts as an intermediary in transmitting the sender's order to the receiving bank. The intermediary is deemed to be an agent of the sender for the purpose of transmitting payment orders and related messages for the sender. Section 4A-206 deals with error by the intermediary.

2. Transmission by an automated clearing house of an association of banks other than the Federal Reserve Banks is an example of a transaction covered by Section 4A-206. Suppose Originator orders Originator's Bank to cause a large number of payments to be made to many accounts in banks in various parts of the country. These payment orders are electronically transmitted to Originator's Bank and stored in an electronic device that is held by Originator's Bank. Or, transmission of the various payment orders is made by delivery to Originator's Bank of an electronic device containing the instruction to the bank. In either case the terms of the various payment orders by Originator are determined by the information contained in the electronic device. In order to execute the various orders, the information in the electronic device must be processed. For example, if some of the orders are for payments to accounts in Bank X

and some to accounts in Bank Y, Originator's Bank will execute these orders of Originator by issuing a series of payment orders to Bank X covering all payments to accounts in that bank, and by issuing a series of payment orders to Bank Y covering all payments to accounts in that bank. The orders to Bank X may be transmitted together by means of an electronic device, and those to Bank Y may be included in another electronic device. Typically, this processing is done by an automated clearing house acting for a group of banks including Originator's Bank. The automated clearing house is a funds transfer system. Section 4A-105(a)(5). Originator's Bank delivers Originator's electronic device or transmits the information contained in the device to the funds transfer system for processing into payment orders of Originator's Bank to the appropriate beneficiary's banks. The processing may result in an erroneous payment order. Originator's Bank, by use of Originator's electronic device, may have given information to the funds transfer system instructing payment of $100,000 to an account in Bank X, but because of human error or an equipment malfunction the processing may have converted that instruction into an instruction to Bank X to make a payment of $1,000,000. Under Section 4A-206, Originator's Bank issued a payment order for $1,000,000 to Bank X when the erroneous information was sent to Bank X. Originator's Bank is responsible for the error of the automated clearing house. The liability of the funds transfer system that made the error is not governed by article 4A. It is left to the law of contract, a funds transfer system rule, or other applicable law.

In the hypothetical case just discussed, if the automated clearing house is operated by a Federal Reserve Bank, the analysis is different. Section 4A-206 does not apply. Originator's Bank will execute Originator's payment orders by delivery or transmission of the electronic information to the Federal Reserve Bank for processing. The result is that Originator's Bank has issued payment orders to the Federal Reserve Bank which, in this case, is acting as an intermediary bank. When the Federal Reserve Bank has processed the information given to it by Originator's Bank it will issue payment orders to the various beneficiary's banks. If the processing results in an erroneous payment order, the Federal Reserve Bank has erroneously executed the payment order of Originator's Bank and the case is governed by Section 4A-303.

4-4.5-207. Misdescription of beneficiary. (a) Subject to subsection (b) of this section, if, in a payment order received by the beneficiary's bank, the name, bank account number, or other identification of the beneficiary refers to a nonexistent or unidentifiable person or account, no person has rights as a beneficiary of the order and acceptance of the order cannot occur.

(b) If a payment order received by the beneficiary's bank identifies the beneficiary both by name and by an identifying or bank account number and the name and number identify different persons, the following rules apply:

(1) Except as otherwise provided in subsection (c) of this section, if the beneficiary's bank does not know that the name and number refer to different persons, it may rely on the number as the proper identification of the beneficiary of the order. The beneficiary's bank need not determine whether the name and number refer to the same person.

(2) If the beneficiary's bank pays the person identified by name or knows that the name and number identify different persons, no person has rights as beneficiary except the person paid by the beneficiary's bank if that person was entitled to receive payment from the originator of the funds transfer. If no person has rights as beneficiary, acceptance of the order cannot occur.

(c) If (i) a payment order described in subsection (b) of this section is accepted, (ii) the originator's payment order described the beneficiary inconsistently by name and number, and (iii) the beneficiary's bank pays the person identified by number as permitted by subsection (b)(1) of this section, the following rules apply:

(1) If the originator is a bank, the originator is obliged to pay its order.

(2) If the originator is not a bank and proves that the person identified by number was not entitled to receive payment from the originator, the originator is not obliged to pay its order unless the originator's bank proves that the originator, before acceptance of the originator's order, had notice that payment of a payment order issued by the originator might be made by the beneficiary's bank on the basis of an identifying or bank account number even if it identifies a person different from the named beneficiary. Proof of notice may be made by any admissible evidence. The originator's bank satisfies the burden of proof if it proves that the originator, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(d) In a case governed by subsection (b)(1) of this section, if the beneficiary's bank rightfully pays the person identified by number and that person was not entitled to receive payment from the originator, the amount paid may be recovered from that person to the extent allowed by the law governing mistake and restitution as follows:

(1) If the originator is obliged to pay its payment order as stated in subsection (c) of this section, the originator has the right to recover.

(2) If the originator is not a bank and is not obliged to pay its payment order, the originator's bank has the right to recover.

Source: L. 90: Entire article added, p. 348, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. Section (a) deals with the problem of payment orders issued to the beneficiary's bank for payment to nonexistent or unidentifiable persons or accounts. Since it is not possible in that case for the funds transfer to be completed, subsection (a) states that the order cannot be accepted. Under Section 4A-402(c), a sender of a payment order is not obliged to pay its order unless the beneficiary's bank accepts a payment order instructing payment to the beneficiary of that sender's order. Thus, if the beneficiary of a funds transfer is nonexistent or unidentifiable, each sender in the funds transfer that has paid its payment order is entitled to get its money back.

2. Subsection (b), which takes precedence over subsection (a), deals with the problem of payment orders in which the description of the beneficiary does not allow identification of the beneficiary because the beneficiary is described by name and by an identifying number or an account number and the name and number refer to different persons. A very large percentage of payment orders issued to the beneficiary's bank by another bank are processed by automated means using machines capable of reading orders on standard formats that identify the beneficiary by an identifying number or the number of a bank account. The processing of the order by the beneficiary's bank and the crediting of the beneficiary's account are done by use of the identifying or bank account number without human reading of the payment order itself. The process is comparable to that used in automated payment of checks. The standard format, however, may also allow the inclusion of the name of the beneficiary and other information which can be useful to the beneficiary's bank and the beneficiary but which plays no part in the process of payment. If the beneficiary's bank has both the account number and name of the beneficiary supplied by the originator of the funds transfer, it is possible for the beneficiary's bank to determine whether the name and number refer to the same person, but if a duty to make that determination is imposed on the beneficiary's bank the benefits of automated payment are lost. Manual handling of payment orders is both expensive and subject to human error. If payment orders can be handled on an automated basis there are substantial economies of operation and the possibility of clerical error is reduced. Subsection (b) allows banks to utilize automated processing by allowing banks to act on the basis of the number without regard to the name if the bank does not know that the name and number refer to different persons. "Know" is defined in Section 1-201(25) to mean actual knowledge, and Section 1-201(27) states rules for determining when an organization has knowledge of information received by the organization. The time of payment is the pertinent time at which knowledge or lack of knowledge must be determined.

Although the clear trend is for beneficiary's banks to process payment orders by automated means, Section 4A-207 is not limited to cases in which processing is done by automated means. A bank that processes by semi-automated means or even manually may rely on number as stated in Section 4A-207.

In cases covered by subsection (b) the erroneous identification would in virtually all cases be the identifying or bank account number. In the typical case the error is made by the originator of the funds transfer. The originator should know the name of the person who is to receive payment and can further identify that person by an address that would normally be known to the originator. It is not unlikely, however, that the originator may not be sure whether the identifying or account number refers to the person the originator intends to pay. Subsection (b)(1) deals with the typical case in which the beneficiary's bank pays on the basis of the account number and is not aware at the time of payment that the named beneficiary is not the holder of the account which was paid. In some cases the false number will be the result of error by the originator. In other cases fraud is involved. For example, Doe is the holder of shares in Mutual Fund. Thief, impersonating Doe, requests redemption of the shares and directs Mutual Fund to wire the redemption proceeds to Doe's account #12345 in Beneficiary's Bank. Mutual Fund originates a funds transfer by issuing a payment order to Originator's Bank to make the

payment to Doe's account #12345 in Beneficiary's Bank. Originator's Bank executes the order by issuing a conforming payment order to Beneficiary's Bank which makes payment to account #12345. That account is the account of Roe rather than Doe. Roe might be a person acting in concert with Thief or Roe might be an innocent third party. Assume that Roe is a gem merchant that agreed to sell gems to Thief who agreed to wire the purchase price to Roe's account in Beneficiary's Bank. Roe believed that the credit to Roe's account was a transfer of funds from Thief and released the gems to Thief in good faith in reliance on the payment. The case law is unclear on the responsibility of a beneficiary's bank in carrying out a payment order in which the identification of the beneficiary by name and number is conflicting. See Securities Fund Services, Inc. v. American National Bank, 542 F. Supp. 323 (N.D.Ill. 1982) and Bradford Trust Co. v. Texas American Bank, 790 F.2d 407 (5th Cir. 1986). Section 4A-207 resolves the issue.

If Beneficiary's Bank did not know about the conflict between the name and number, subsection (b)(1) applies. Beneficiary's Bank has no duty to determine whether there is a conflict and it may rely on the number as the proper identification of the beneficiary of the order. When it accepts the order, it is entitled to payment from Originator's Bank. Section 4A-402(b). On the other hand, if Beneficiary's Bank knew about the conflict between the name and number and nevertheless paid Roe, subsection (b)(2) applies. Under that provision, acceptance of the payment order of Originator's Bank did not occur because there is no beneficiary of that order. Since acceptance did not occur Originator's Bank is not obliged to pay Beneficiary's Bank. Section 4A-402(b). Similarly, Mutual Fund is excused from its obligation to pay Originator's Bank. Section 4A-402(c). Thus, Beneficiary's Bank takes the loss. Its only cause of action is against Thief. Roe is not obliged to return the payment to the beneficiary's bank because Roe received the payment in good faith and for value. Article 4A makes irrelevant the issue of whether Mutual Fund was or was not negligent in issuing its payment order.

3. Normally, subsection (b)(1) will apply to the hypothetical case discussed in Comment 2. Beneficiary's Bank will pay on the basis of the number without knowledge of the conflict. In that case subsection (c) places the loss on either Mutual Fund or Originator's Bank. It is not unfair to assign the loss to Mutual Fund because it is the person who dealt with the impostor and it supplied the wrong account number. It could have avoided the loss if it had not used an account number that it was not sure was that of Doe. Mutual Fund, however, may not have been aware of the risk involved in giving both name and number. Subsection (c) is designed to protect the originator, Mutual Fund, in this case. Under that subsection, the originator is responsible for the inconsistent description of the beneficiary if it had notice that the order might be paid by the beneficiary's bank on the basis of the number. If the originator is a bank, the originator always has that responsibility. The rationale is that any bank should know how payment orders are processed and paid. If the originator is not a bank, the originator's bank must prove that its customer, the originator, had notice. Notice can be proved by any admissible evidence, but the bank can always prove notice by providing the customer with a written statement of the required information and obtaining the customer's signature to the statement. That statement will then apply to any payment order accepted by the bank thereafter. The information need not be supplied more than once.

In the hypothetical case if Originator's Bank made the disclosure stated in the last sentence of subsection (c)(2), Mutual Fund must pay Originator's Bank. Under subsection (d)(1), Mutual Fund has an action to recover from Roe if recovery from Roe is permitted by the law governing mistake and restitution. Under the assumed facts Roe should be entitled to keep the money as a person who took it in good faith and for value since it was taken as payment for the gems. In that case, Mutual Fund's only remedy is against Thief. If Roe was not acting in good faith, Roe has to return the money to Mutual Fund. If Originator's Bank does not prove that Mutual Fund had notice as stated in subsection (c)(2), Mutual Fund is not required to pay Originator's Bank. Thus, the risk of loss falls on Originator's Bank whose remedy is against Roe or Thief as stated above. Subsection (d)(2).

4-4.5-208. Misdescription of intermediary bank or beneficiary's bank. (a) This subsection (a) applies to a payment order identifying an intermediary bank or the beneficiary's bank only by an identifying number.

(1) The receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank and need not determine whether the number identifies a bank.

(2) The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(b) This subsection (b) applies to a payment order identifying an intermediary bank or

the beneficiary's bank both by name and an identifying number if the name and number identify different persons.

(1) If the sender is a bank, the receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank if the receiving bank, when it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person or whether the number refers to a bank. The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(2) If the sender is not a bank and the receiving bank proves that the sender, before the payment order was accepted, had notice that the receiving bank might rely on the number as the proper identification of the intermediary or beneficiary's bank even if it identifies a person different from the bank identified by name, the rights and obligations of the sender and the receiving bank are governed by subsection (b)(1) of this section, as though the sender were a bank. Proof of notice may be made by any admissible evidence. The receiving bank satisfies the burden of proof if it proves that the sender, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(3) Regardless of whether the sender is a bank, the receiving bank may rely on the name as the proper identification of the intermediary or beneficiary's bank if the receiving bank, at the time it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person.

(4) If the receiving bank knows that the name and number identify different persons, reliance on either the name or the number in executing the sender's payment order is a breach of the obligation stated in section 4-4.5-302(a)(1).

Source: L. 90: Entire article added, p. 349, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. This section addresses an issue similar to that addressed by Section 4A-207. Because of automation in the processing of payment orders, a payment order may identify the beneficiary's bank or an intermediary bank by an identifying number. The bank identified by number might or might not also be identified by name. The following two cases illustrate Section 4A-208(a) and (b):

Case #1. Originator's payment order to Originator's Bank identifies the beneficiary's bank as Bank A and instructs payment to Account #12345 in that bank. Originator's Bank executes Originator's order by issuing a payment order to Intermediary Bank. In the payment order of Originator's Bank the beneficiary's bank is identified as Bank A but is also identified by number, #67890. The identifying number refers to Bank B rather than Bank A. If processing by Intermediary Bank of the payment order of Originator's Bank is done by automated means, Intermediary Bank, in executing the order, will rely on the identifying number and will issue a payment order to Bank B rather than Bank A. If there is an Account #12345 in Bank B, the payment order of Intermediary Bank would normally be accepted and payment would be made to a person not intended by Originator. In this case, Section 4A-208(b)(1) puts the risk of loss on Originator's Bank. Intermediary Bank may rely on the number #67890 as the proper identification of the beneficiary's bank. Intermediary Bank has properly executed the payment order of Originator's Bank. By using the wrong number to describe the beneficiary's bank, Originator's Bank has improperly executed Originator's payment order because the payment order of Originator's Bank provides for payment to the wrong beneficiary, the holder of Account #12345 in Bank B rather than the holder of Account #12345 in Bank A. Section 4A-302(a)(1) and Section 4A-303(c). Originator's Bank is not entitled to payment from originator but is required to pay Intermediary Bank. Section 4A-303(c) and Section 4A-402(c). Intermediary Bank is also entitled to compensation for any loss and expenses resulting from the error by Originator's Bank.

If there is no Account #12345 in Bank B, the result is that there is no beneficiary of the payment order issued by Originator's Bank and the funds transfer will not be completed. Originator's Bank is not entitled to payment from Originator and Intermediary Bank is not entitled to payment from Originator's Bank. Section 4A-402(c). Since Originator's Bank improperly executed Originator's payment order it may be liable for damages under Section 4A-305. As

stated above, Intermediary Bank is entitled to compensation for loss and expenses resulting from the error by Originator's Bank.

Case #2. Suppose the same payment order by Originator to Originator's I Bank as in Case #1. In executing the payment order Originator's Bank issues a payment order to Intermediary Bank in which the beneficiary's bank is identified only by number, #67890. That number does not refer to Bank A. Rather, it identifies a person that is not a bank. If processing by Intermediary Bank of the payment order of Originator's Bank is done by automated means, Intermediary Bank will rely on the number #67890 to identify the beneficiary's bank. Intermediary Bank has no duty to determine whether the number identifies a bank. The funds transfer cannot be completed in this case because no bank is identified as the beneficiary's bank. Subsection (a) puts the risk of loss on Originator's Bank. Originator's Bank is not entitled to payment from Originator. Section 4A-402(c). Originator's Bank has improperly executed Originator's payment order and may be liable for damages under Section 4A-305. Originator's Bank is obliged to compensate Intermediary Bank for loss and expenses resulting from the error by Originator's Bank.

Subsection (a) also applies if #67890 identifies a bank, but the bank is not Bank A. Intermediary Bank may rely on the number as the proper identification of the beneficiary's bank. If the bank to which Intermediary Bank sends its payment order accepts the order, Intermediary Bank is entitled to payment from Originator's Bank, but Originator's Bank is not entitled to payment from Originator. The analysis is similar to that in Case #1.

2. Subsection (b)(2) of Section 4A-208 addresses cases in which an erroneous identification of a beneficiary's bank or intermediary bank by name and number is made in a payment order of a sender that is not a bank. Suppose Originator issues a payment order to Originator's Bank that instructs that bank to use an intermediary bank identified as Bank A and by an identifying number, #67890. The identifying number refers to Bank B. Originator intended to identify Bank A as intermediary bank. If Originator's Bank relied on the number and issued a payment order to Bank B the rights of Originator's Bank depend upon whether the proof of notice stated in subsection (b)(2) is made by Originator's Bank. If proof is made, Originator's Bank's rights are governed by subsection (b)(1) of Section 4A-208. Originator's Bank is not liable for breach of Section 4A-302(a)(1) and is entitled to compensation from Originator for any loss and expenses resulting from Originator's error. If notice is not proved, Originator's Bank may not rely on the number in executing Originator's payment order. Since Originator's Bank does not get the benefit of subsection (b)(1) in that case, Originator's Bank improperly executed Originator's payment order and is in breach of the obligation stated in Section 4A-302(a)(1). If notice is not given, Originator's Bank can rely on the name if it is not aware of the conflict in name and number. Subsection (b)(3).

3. Although the principal purpose of Section 4A-208 is to accommodate automated processing of payment orders, Section 4A-208 applies regardless of whether processing is done by automation, semi-automated means or manually.

4-4.5-209. Acceptance of payment order. (a) Subject to subsection (d) of this section, a receiving bank other than the beneficiary's bank accepts a payment order when it executes the order.

(b) Subject to subsections (c) and (d) of this section, a beneficiary's bank accepts a payment order at the earliest of the following times:

(1) When the bank (i) pays the beneficiary as stated in section 4-4.5-405(a) or 4-4.5-405(b), or (ii) notifies the beneficiary of receipt of the order or that the account of the beneficiary has been credited with respect to the order unless the notice indicates that the bank is rejecting the order or that funds with respect to the order may not be withdrawn or used until receipt of payment from the sender of the order;

(2) When the bank receives payment of the entire amount of the sender's order pursuant to section 4-4.5-403(a)(1) or 4-4.5-403(a)(2); or

(3) The opening of the next funds-transfer business day of the bank following the payment date of the order if, at that time, the amount of the sender's order is fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender, unless the order was rejected before that time or is rejected within (i) one hour after that time, or (ii) one hour after the opening of the next business day of the sender following the payment date if that time is later. If notice of rejection is received by the sender after the payment date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the payment date to the day the sender receives notice or learns that the order was not accepted, counting that day as an

elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest payable is reduced accordingly.

(c) Acceptance of a payment order cannot occur before the order is received by the receiving bank. Acceptance does not occur under subsection (b)(2) or (b)(3) of this section if the beneficiary of the payment order does not have an account with the receiving bank, the account has been closed, or the receiving bank is not permitted by law to receive credits for the beneficiary's account.

(d) A payment order issued to the originator's bank cannot be accepted until the payment date if the bank is the beneficiary's bank, or the execution date if the bank is not the beneficiary's bank. If the originator's bank executes the originator's payment order before the execution date or pays the beneficiary of the originator's payment order before the payment date and the payment order is subsequently canceled pursuant to section 4-4.5-211(b), the bank may recover from the beneficiary any payment received to the extent allowed by the law governing mistake and restitution.

Source: L. 90: Entire article added, p. 350, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. This section treats the sender's payment order as a request by the sender to the receiving bank to execute or pay the order and that request can be accepted or rejected by the receiving bank. Section 4A-209 defines when acceptance occurs. Section 4A-210 covers rejection. Acceptance of the payment order imposes an obligation on the receiving bank to the sender if the receiving bank is not the beneficiary's bank, or to the beneficiary if the receiving bank is the beneficiary's bank. These obligations are stated in Section 4A-302 and Section 4A-404.

2. Acceptance by a receiving bank other than the beneficiary's bank is defined in Section 4A-209(a). That subsection states the only way that a bank other than the beneficiary's bank can accept a payment order. A payment order to a bank other than the beneficiary's bank is, in effect, a request that the receiving bank execute the sender's order by issuing a payment order to the beneficiary's bank or to an intermediary bank. Normally, acceptance occurs at the time of execution, but there is an exception stated in subsection (d) and discussed in Comment 9. Execution occurs when the receiving bank "issues a payment order intended to carry out" the sender's order. Section 4A-301(a). In some cases the payment order issued by the receiving bank may not conform to the sender's order. For example, the receiving bank might make a mistake in the amount of its order, or the order might be issued to the wrong beneficiary's bank or for the benefit of the wrong beneficiary. In all of these cases there is acceptance of the sender's order by the bank when the receiving bank issues its order intended to carry out the sender's order, even though the bank's payment order does not in fact carry out the instruction of the sender. Improper execution of the sender's order may lead to liability to the sender for damages or it may mean that the sender is not obliged to pay its payment order. These matters are covered in Section 4A-303, Section 4A-305, and Section 4A-402.

3. A receiving bank has no duty to accept a payment order unless the bank makes an agreement, either before or after issuance of the payment order, to accept it, or acceptance is required by a funds transfer system rule. If the bank makes such an agreement it incurs a contractual obligation based on the agreement and may be held liable for breach of contract if a failure to execute violates the agreement. In many cases a bank will enter into an agreement with its customer to govern the rights and obligations of the parties with respect to payment orders issued to the bank by the customer or, in cases in which the sender is also a bank, there may be a funds transfer system rule that governs the obligations of a receiving bank with respect to payment orders transmitted over the system. Such agreements or rules can specify the circumstances under which a receiving bank is obliged to execute a payment order and can define the extent of liability of the receiving bank for breach of the agreement or rule. Section 4A-305(d) states the liability for breach of an agreement to execute a payment order.

4. In the case of a payment order issued to the beneficiary's bank, acceptance is defined in Section 4A-209(b). The function of a beneficiary's bank that receives a payment order is different from that of a receiving bank that receives a payment order for execution. In the typical case, the beneficiary's bank simply receives payment from the sender of the order, credits the account of the beneficiary and notifies the beneficiary of the credit. Acceptance by the beneficiary's bank does not create any obligation to the sender. Acceptance by the beneficiary's bank means that the bank is liable to the beneficiary for the amount of the order. Section 4A-404(a). There are three ways in which the beneficiary's

bank can accept a payment order which are described in the following comments.

5. Under Section 4A-209(b)(1), the beneficiary's bank can accept a payment order by paying the beneficiary. In the normal case of crediting an account of the beneficiary, payment occurs when the beneficiary is given notice of the right to withdraw the credit, the credit is applied to a debt of the beneficiary, or "funds with respect to the order" are otherwise made available to the beneficiary. Section 4A-405(a). The quoted phrase covers cases in which funds are made available to the beneficiary as a result of receipt of a payment order for the benefit of the beneficiary but the release of funds is not expressed as payment of the order. For example, the beneficiary's bank might express a release of funds equal to the amount of the order as a "loan" that will be automatically repaid when the beneficiary's bank receives payment by the sender of the order. If the release of funds is designated as a loan pursuant to a routine practice of the bank, the release is conditional payment of the order rather than a loan, particularly if normal incidents of a loan such as the signing of a loan agreement or note and the payment of interest are not present. Such a release of funds is payment to the beneficiary under Section 4A-405(a). Under Section 4A-405(c) the bank cannot recover the money from the beneficiary if the bank does not receive payment from the sender of the payment order that it accepted. Exceptions to this rule are stated in section 4A-405(d) and (e). The beneficiary's bank may also accept by notifying the beneficiary that the order has been received. "Notifies" is defined in Section 1-201 (26). In some cases a beneficiary's bank will receive a payment order during the day but settlement of the sender's obligation to pay the order will not occur until the end of the day. If the beneficiary's bank wants to defer incurring liability to the beneficiary until the beneficiary's bank receives payment, it can do so. The beneficiary's bank incurs no liability to the beneficiary with respect to a payment order that it receives until it accepts the order. If the bank does not accept pursuant to subsection (b)(1), acceptance does not occur until the end of the day when the beneficiary's bank receives settlement. If the sender settles, the payment order will be accepted under subsection (b)(2) and the funds will be released to the beneficiary the next morning. If the sender doesn't settle, no acceptance occurs. In either case the beneficiary's bank suffers no loss.

6. In most cases the beneficiary's bank will receive a payment order from another bank. If the sender is a bank and the beneficiary's bank receives payment from the sender by final settlement through the Federal Reserve System or a funds transfer system (Section 4A-403(a)(1)) or, less commonly, through credit to an account of the beneficiary's bank with the sender or another bank (Section 4A-403(a)(2)), acceptance by the beneficiary's bank occurs at the time payment is made. Section 4A-209(b)(2). A minor exception to this rule is stated in Section 4A-209(c). Section 4A-209(b)(2) results in automatic acceptance of payment orders issued to a beneficiary's bank by means of Fedwire because the Federal Reserve account of the beneficiary's bank is credited and final payment is made to that bank when the payment order is received.

Subsection (b)(2) would also apply to cases in which the beneficiary's bank mistakenly pays a person who is not the beneficiary of the payment order issued to the beneficiary's bank. For example, suppose the payment order provides for immediate payment to Account #12345. The beneficiary's bank erroneously credits Account #12346 and notifies the holder of that account of the credit. No acceptance occurs in this case under subsection (b)(1) because the beneficiary of the order has not been paid or notified. The holder of Account #12345 is the beneficiary of the order issued to the beneficiary's bank. But acceptance will normally occur if the beneficiary's bank takes no other action, because the bank will normally receive settlement with respect to the payment order. At that time the bank has accepted because the sender paid its payment order. The bank is liable to pay the holder of Account #12345. The bank has paid the holder of Account #12346 by mistake, and has a right to recover the payment if the credit is withdrawn, to the extent provided in the law governing mistake and restitution.

7. Subsection (b)(3) covers cases of inaction by the beneficiary's bank. It applies whether or not the sender is a bank and covers a case in which the sender and the beneficiary both have accounts with the receiving bank and payment will be made by debiting the account of the sender and crediting the account of the beneficiary. Subsection (b)(3) is similar to subsection (b)(2) in that it bases acceptance by the beneficiary's bank on payment by the sender. Payment by the sender is effected by a debit to the sender's account if the account balance is sufficient to cover the amount of the order. On the payment date (Section 4A-401) of the order the beneficiary's bank will normally credit the beneficiary's account and notify the beneficiary of receipt of the order if it is satisfied that the sender's account balance covers the order or is willing to give credit to the sender. In some cases, however, the bank may not be willing to give credit to the sender and it may not be possible for the bank to determine until the end of the day on the payment date whether there are sufficient good funds in the sender's account. There may be various transactions during the day involving funds going into and out of the account. Some of these transactions may occur late in the day or after the close of the banking day. To accommodate this situation, subsection

(b)(3) provides that the status of the account is determined at the opening of the next funds transfer business day of the beneficiary's bank after the payment date of the order. If the sender's account balance is sufficient to cover the order, the beneficiary's bank has a source of payment and the result in almost all cases is that the bank accepts the order at that time if it did not previously accept under subsection (b)(1). In rare cases, a bank may want to avoid acceptance under subsection (b)(3) by rejecting the order as discussed in Comment 8.

8. Section 4A-209 is based on a general principle that a receiving bank is not obliged to accept a payment order unless it has agreed or is bound by a funds transfer system rule to do so. Thus, provision is made to allow the receiving bank to prevent acceptance of the order. This principle is consistently followed if the receiving bank is not the beneficiary's bank. If the receiving bank is not the beneficiary's bank, acceptance is in the control of the receiving bank because it occurs only if the order is executed. But in the case of the beneficiary's bank acceptance can occur by passive receipt of payment under subsection (b)(2) or (3). In the case of a payment made by Fedwire acceptance cannot be prevented. In other cases the beneficiary's bank can prevent acceptance by giving notice of rejection to the sender before payment occurs under Section 4A-403(a)(1) or (2). A minor exception to the ability of the beneficiary's bank to reject is stated in Section 4A-502(c)(3).

Under subsection (b)(3) acceptance occurs at the opening of the next funds transfer business day of the beneficiary's bank following the payment date unless the bank rejected the order before that time or it rejects within one hour after that time. In some cases the sender and the beneficiary's bank may not be in the same time zone or the beginning of the business day of the sender and the funds transfer business day of the beneficiary's bank may not coincide. For example, the sender may be located in California and the beneficiary's bank in New York. Since in most cases notice of rejection would be communicated electronically or by telephone, it might not be feasible for the bank to give notice before one hour after the opening of the funds transfer business day in New York because at that hour, the sender's business day may not have started in California. For that reason, there are alternative deadlines stated in subsection (b)(3). In the case stated, the bank acts in time if it gives notice within one hour after the opening of the business day of the sender. But if the notice of rejection is received by the sender after the payment date, the bank is obliged to pay interest to the sender if the sender's account does not bear interest. In that case the bank had the use of funds of the sender that the sender could reasonably assume would be used to pay the beneficiary. The rate of interest is stated in Section 4A-506. If the sender receives notice on the day after the payment date the sender is entitled to one day's interest. If receipt of notice is delayed for more than one day, the sender is entitled to interest for each additional day of delay.

9. Subsection (d) applies only to a payment order by the originator of a funds transfer to the originator's bank and it refers to the following situation. On April 1, Originator instructs Bank A to make a payment on April 15 to the account of Beneficiary in Bank B. By mistake, on April 1, Bank A executes Originator's payment order by issuing a payment order to Bank B instructing immediate payment to Beneficiary. Bank B credited Beneficiary's account and immediately released the funds to Beneficiary. Under subsection (d) no acceptance by Bank A occurred on April 1 when Originator's payment order was executed because acceptance cannot occur before the execution date which in this case would be April 15 or shortly before that date. Section 4A-301(b). Under Section 4A-402(c), Originator is not obliged to pay Bank A until the order is accepted and that can't occur until the execution date. But Bank A is required to pay Bank B when Bank B accepted Bank A's order on April 1. Unless Originator and Beneficiary are the same person, in almost all cases Originator is paying a debt owed to Beneficiary and early payment does not injure Originator because Originator does not have to pay Bank A until the execution date. Section 4A-402(c). Bank A takes the interest loss. But suppose that on April 3, Originator concludes that no debt was owed to Beneficiary or that the debt was less than the amount of the payment order. Under Section 4A-211(b) Originator can cancel its payment order if Bank A has not accepted. If early execution of Originator's payment order is acceptance, Originator can suffer a loss because cancellation after acceptance is not possible without the consent of Bank A and Bank B. Section 4A-211(c). If Originator has to pay Bank A, Originator would be required to seek recovery of the money from Beneficiary. Subsection (d) prevents this result and puts the risk of loss on Bank A by providing that the early execution does not result in acceptance until the execution date. Since on April 3 Originator's order was not yet accepted, Originator can cancel it under Section 4A-211(b). The result is that Bank A is not entitled to payment from Originator but is obliged to pay Bank B. Bank A has paid Beneficiary by mistake. If Originator's payment order is cancelled, Bank A becomes the originator of an erroneous funds transfer to Beneficiary. Bank A has the burden of recovering payment from Beneficiary on the basis of a payment by mistake. If Beneficiary received the money in good faith in payment of a debt owed to Beneficiary by Originator, the law of mistake and restitution may allow Beneficiary to keep all or part of the money received. If Originator owed

money to Beneficiary, Bank A has paid Originator's debt and, under the law of restitution, which applies pursuant to Section 1-103, Bank A is subrogated to Beneficiary's rights against Originator on the debt.

If Bank A is the Beneficiary's bank and Bank A credited Beneficiary's account and released the funds to Beneficiary on April 1, the analysis is similar. If Originator's order is cancelled, Bank A has paid Beneficiary by mistake. The right of Bank A to recover the payment from Beneficiary is similar to Bank A's rights in the preceding paragraph.

4-4.5-210. Rejection of payment order. (a) A payment order is rejected by the receiving bank by a notice of rejection transmitted to the sender orally, electronically, or in writing. A notice of rejection need not use any particular words and is sufficient if it indicates that the receiving bank is rejecting the order or will not execute or pay the order. Rejection is effective when the notice is given if transmission is by a means that is reasonable in the circumstances. If notice of rejection is given by a means that is not reasonable, rejection is effective when the notice is received. If an agreement of the sender and receiving bank establishes the means to be used to reject a payment order, (i) any means complying with the agreement is reasonable and (ii) any means not complying is not reasonable unless no significant delay in receipt of the notice resulted from the use of the noncomplying means.

(b) This subsection (b) applies if a receiving bank other than the beneficiary's bank fails to execute a payment order despite the existence on the execution date of a withdrawable credit balance in an authorized account of the sender sufficient to cover the order. If the sender does not receive notice of rejection of the order on the execution date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the execution date to the earlier of the day the order is canceled pursuant to section 4-4.5-211 (d) or the day the sender receives notice or learns that the order was not executed, counting the final day of the period as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest is reduced accordingly.

(c) If a receiving bank suspends payments, all unaccepted payment orders issued to it are deemed rejected at the time the bank suspends payments.

(d) Acceptance of a payment order precludes a later rejection of the order. Rejection of a payment order precludes a later acceptance of the order.

Source: L. 90: Entire article added, p. 351, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. With respect to payment orders issued to a receiving bank other than the beneficiary's bank, notice of rejection is not necessary to prevent acceptance of the order. Acceptance can occur only if the receiving bank executes the order. Section 4A-209(a). But notice of rejection will routinely be given by such a bank in cases in which the bank cannot or is not willing to execute the order for some reason. There are many reasons why a bank doesn't execute an order. The payment order may not clearly instruct the receiving bank because of some ambiguity in the order or an internal inconsistency. In some cases, the receiving bank may not be able to carry out the instruction because of equipment failure, credit limitations on the receiving bank, or some other factor which makes proper execution of the order infeasible. In those cases notice of rejection is a means of informing the sender of the facts so that a corrected payment order can be transmitted or the sender can seek alternate means of completing the funds transfer. The other major reason for not executing an order is that the sender's account is insufficient to cover the order and the receiving bank is not willing to give credit to the sender. If the sender's account is sufficient to cover the order and the receiving bank chooses not to execute the order, notice of rejection is necessary to prevent liability to pay interest to the sender if the case falls within Section 4A-210(b) which is discussed in Comment 3.

2. A payment order to the beneficiary's bank can be accepted by inaction of the bank. Section 4A-209(b) (2) and (3). To prevent acceptance under those provisions it is necessary for the receiving bank to send notice of rejection before acceptance occurs. Subsection (a) of Section 4A-210 states the rule that rejection is accomplished by giving notice of rejection. This incorporates the definitions in Section 1-201(26). Rejection is effective when notice is given if it is given by a means that is reasonable in the circumstances. Otherwise it is effective

when the notice is received. The question of when rejection is effective is important only in the relatively few cases under subsection (b)(2) and (3) in which a notice of rejection is necessary to prevent acceptance. The question of whether a particular means is reasonable depends on the facts in a particular case. In a very large percentage of cases the sender and the receiving bank will be in direct electronic contact with each other and in those cases a notice of rejection can be transmitted instantaneously. Since time is of the essence in a large proportion of funds transfers, some quick means of transmission would usually be required, but this is not always the case. The parties may specify by agreement the means by which communication between the parties is to be made.

3. Subsection (b) deals with cases in which a sender does not learn until after the execution date that the sender's order has not been executed. It applies only to cases in which the receiving bank was assured of payment because the sender's account was sufficient to cover the order. Normally, the receiving bank will accept the sender's order if it is assured of payment, but there may be some cases in which the bank chooses to reject. Unless the receiving bank had obligated itself by agreement to accept, the failure to accept is not wrongful. There is no duty of the receiving bank to accept the payment order unless it is obliged to accept by express agreement. Section 4A-212. But even if the bank has not acted wrongfully, the receiving bank had the use of the sender's money that the sender could reasonably assume was to be the source of payment of the funds transfer. Until the sender learns that the order was not accepted the sender is denied the use of that money. Subsection (b) obliges the receiving bank to pay interest to the sender as restitution unless the sender receives notice of rejection on the execution date. The time of receipt of notice is determined pursuant to section 1-201(27). The rate of interest is stated in Section 4A-506. If the sender receives notice on the day after the execution date, the sender is entitled to one day's interest. If receipt of notice is delayed for more than one day, the sender is entitled to interest for each additional day of delay.

4. Subsection (d) treats acceptance and rejection as mutually exclusive. If a payment order has been accepted, rejection of that order becomes impossible. If a payment order has been rejected it cannot be accepted later by the receiving bank. Once notice of rejection has been given, the sender may have acted on the notice by making the payment through other channels. If the receiving bank wants to act on a payment order that it has rejected it has to obtain the consent of the sender. In that case the consent of the sender would amount to the giving of a second payment order that substitutes for the rejected first order. If the receiving bank suspends payments (Section 4-104(1)(k)), subsection (c) provides that unaccepted payment orders are deemed rejected at the time suspension of payments occurs. This prevents acceptance by passage of time under Section 4A-209(b)(3).

4-4.5-211. Cancellation and amendment of payment order. (a) A communication of the sender of a payment order cancelling or amending the order may be transmitted to the receiving bank orally, electronically, or in writing. If a security procedure is in effect between the sender and the receiving bank, the communication is not effective to cancel or amend the order unless the communication is verified pursuant to the security procedure or the bank agrees to the cancellation or amendment.

(b) Subject to subsection (a) of this section, a communication by the sender cancelling or amending a payment order is effective to cancel or amend the order if notice of the communication is received at a time and in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order.

(c) After a payment order has been accepted, cancellation or amendment of the order is not effective unless the receiving bank agrees or a funds-transfer system rule allows cancellation or amendment without agreement of the bank.

(1) With respect to a payment order accepted by a receiving bank other than the beneficiary's bank, cancellation or amendment is not effective unless a conforming cancellation or amendment of the payment order issued by the receiving bank is also made.

(2) With respect to a payment order accepted by the beneficiary's bank, cancellation or amendment is not effective unless the order was issued in execution of an unauthorized payment order, or because of a mistake by a sender in the funds transfer which resulted in the issuance of a payment order (i) that is a duplicate of a payment order previously issued by the sender, (ii) that orders payment to a beneficiary not entitled to receive payment from the originator, or (iii) that orders payment in an amount greater than the amount the beneficiary was entitled to receive from the originator. If the payment order is canceled or amended, the beneficiary's bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(d) An unaccepted payment order is canceled by operation of law at the close of the fifth funds-transfer business day of the receiving bank after the execution date or payment date of the order.

(e) A canceled payment order cannot be accepted. If an accepted payment order is canceled, the acceptance is nullified and no person has any right or obligation based on the acceptance. Amendment of a payment order is deemed to be cancellation of the original order at the time of amendment and issue of a new payment order in the amended form at the same time.

(f) Unless otherwise provided in an agreement of the parties or in a funds-transfer system rule, if the receiving bank, after accepting a payment order, agrees to cancellation or amendment of the order by the sender or is bound by a funds-transfer system rule allowing cancellation or amendment without the bank's agreement, the sender, whether or not cancellation or amendment is effective, is liable to the bank for any loss and expenses, including reasonable attorney's fees, incurred by the bank as a result of the cancellation or amendment or attempted cancellation or amendment.

(g) A payment order is not revoked by the death or legal incapacity of the sender unless the receiving bank knows of the death or of an adjudication of incapacity by a court of competent jurisdiction and has reasonable opportunity to act before acceptance of the order.

(h) A funds-transfer system rule is not effective to the extent it conflicts with subsection (c)(2) of this section.

Source: L. 90: Entire article added, p. 351, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. This section deals with cancellation and amendment of payment orders. It states the conditions under which cancellation or amendment is both effective and rightful. There is no concept of wrongful cancellation or amendment of a payment order. If the conditions stated in this section are not met the attempted cancellation or amendment is not effective. If the stated conditions are met the cancellation or amendment is effective and rightful. The sender of a payment order may want to withdraw or change the order because the sender has had a change of mind about the transaction or because the payment order was erroneously issued or for any other reason. One common situation is that of multiple transmission of the same order. The sender that mistakenly transmits the same order twice wants to correct the mistake by cancelling the duplicate order. Or, a sender may have intended to order a payment of $1,000,000 but mistakenly issued an order to pay $10,000,000. In this case the sender might try to correct the mistake by cancelling the order and issuing another order in the proper amount. Or, the mistake could be corrected by amending the order to change it to the proper amount. Whether the error is corrected by amendment or cancellation and reissue the net result is the same. This result is stated in the last sentence of subsection (e).

2. Subsection (a) allows a cancellation or amendment of a payment order to be communicated to the receiving bank "orally, electronically, or in writing." The quoted phrase is consistent with the language of Section 4A-103(a) applicable to payment orders. Cancellations and amendments are normally subject to verification pursuant to security procedures to the same extent as payment orders. Subsection (a) recognizes this fact by providing that in cases in which there is a security procedure in effect between the sender and the receiving bank the bank is not bound by a communication cancelling or amending an order unless verification has been made. This is necessary to protect the bank because under subsection (b) a cancellation or amendment can be effective by unilateral action of the sender. Without verification the bank cannot be sure whether the communication was or was not effective to cancel or amend a previously verified payment order.

3. If the receiving bank has not yet accepted the order, there is no reason why the sender should not be able to cancel or amend the order unilaterally so long as the requirements of subsection (a) and (b) are met. If the receiving bank has accepted the order, it is possible to cancel or amend but only if the requirements of subsection (c) are met.

First consider the case of a receiving bank other than the beneficiary's bank. If the bank has not yet accepted the order, the sender can unilaterally cancel or amend. The communication amending or cancelling the payment order must be received in time to allow the bank to act on it before the bank issues its payment order in execution of the sender's order. The time that the sender's communication is received is governed by Section 4A-106. If a payment order does not specify a delayed payment date or execution date, the order will normally be exe-

cuted shortly after receipt. Thus, as a practical matter, the sender will have very little time in which to instruct cancellation or amendment before acceptance. In addition, a receiving bank will normally have cut-off times for receipt of such communications, and the receiving bank is not obliged to act on communications received after the cut-of hour. Cancellation by the sender after execution of the order by the receiving bank requires the agreement of the bank unless a funds transfer rule otherwise provides. Subsection (c). Although execution of the sender's order by the receiving bank does not itself impose liability on the receiving bank (under Section 4A-402 no liability is incurred by the receiving bank to pay its order until it is accepted), it would commonly be the case that acceptance follows shortly after issuance. Thus, as a practical matter, a receiving bank that has executed a payment order will incur a liability to the next bank in the chain before it would be able to act on the cancellation request of its customer. It is unreasonable to impose on the receiving bank a risk of loss with respect to a cancellation request without the consent of the receiving bank.

The statute does not state how or when the agreement of the receiving bank must be obtained for cancellation after execution. The receiving bank's consent could be obtained at the time cancellation occurs or it could be based on a preexisting agreement. Or, a funds transfer system rule could provide that cancellation can be made unilaterally by the sender. By virtue of that rule any receiving bank covered by the rule is bound. Section 4A-501. If the receiving bank has already executed the sender's order, the bank would not consent to cancellation unless the bank to which the receiving bank has issued its payment order consents to cancellation of that order. It makes no sense to allow cancellation of a payment order unless all subsequent payment orders in the funds transfer that were issued because of the cancelled payment order are also cancelled. Under subsection (c)(1), if a receiving bank consents to cancellation of the payment order after it is executed, the cancellation is not effective unless the receiving bank also cancels the payment order issued by the bank.

4. With respect to a payment order issued to the beneficiary's bank, acceptance is particularly important because it creates liability to pay the beneficiary, it defines when the originator pays its obligation to the beneficiary, and it defines when any obligation for which the payment is made is discharged. Since acceptance affects the rights of the originator and the beneficiary it is not appropriate to allow the beneficiary's bank to agree to cancellation or amendment except in unusual cases. Except as provided in subsection (c)(2), cancellation or amendment after acceptance by the beneficiary's bank is not possible unless all parties affected by the order agree. Under subsection (c)(2), cancellation or amendment is possible only in the four cases stated. The following examples illustrate subsection (c)(2):

Case #1. Originator's Bank executed a payment order issued in the name of its customer as sender. The order was not authorized by the customer and was fraudulently issued. Beneficiary's Bank accepted the payment order issued by Originator's Bank. Under subsection (c)(2) Originator's Bank can cancel the order if Beneficiary's Bank consents. It doesn't make any difference whether the payment order that Originator's Bank accepted was or was not enforceable against the customer under Section 4A-202(b). Verification under that provision is important in determining whether Originator's Bank or the customer has the risk of loss, but it has no relevance under Section 4A-211(c)(2). Whether or not verified, the payment order was not authorized by the customer. Cancellation of the payment order to Beneficiary's Bank causes the acceptance of Beneficiary's Bank to be nullified. Subsection (e). Beneficiary's Bank is entitled to recover payment from the beneficiary to the extent allowed by the law of mistake and restitution. In this kind of case the beneficiary is usually a party to the fraud who has no right to receive or retain payment of the order.

Case #2. Originator owed Beneficiary $1,000,000 and ordered Bank A to pay that amount to the account of Beneficiary in Bank B. Bank A issued a complying order to Bank B, but by mistake issued a duplicate order as well. Bank B accepted both orders. Under subsection (c)(2)(i) cancellation of the duplicate order could be made by Bank A with the consent of Bank B. Beneficiary has no right to receive or retain payment of the duplicate payment order if only $1,000,000 was owed by Originator to Beneficiary. If Originator owed $2,000,000 to Beneficiary, the law of restitution might allow Beneficiary to retain the $1,000,000 paid by Bank B on the duplicate order. In that case Bank B is entitled to reimbursement from Bank A under subsection (f).

Case #3. Originator owed $1,000,000 to X. Intending to pay X, Originator ordered Bank A to pay $1,000,000 to Y's account in Bank B. Bank A issued a complying payment order to Bank B which Bank B accepted by releasing the $1,000,000 to Y. Under subsection (c)(2)(ii) Bank A can cancel its payment order to Bank B with the consent of Bank B if Y was not entitled to receive payment from Originator. Originator can also cancel its order to Bank A with Bank A's consent. Subsection (c) (1). Bank B may recover the $1,000,000 from Y unless the law of mistake and restitution allows Y to retain some or all of the amount paid. If no debt was owed to Y, Bank B should have a right of recovery.

Case #4. Originator owed Beneficiary $10,000. By mistake Originator ordered Bank A

to pay $1,000,000 to the account of Beneficiary in Bank B. Bank A issued a complying order to Bank B which accepted by notifying Beneficiary of its right to withdraw $1,000,000. Cancellation is permitted in this case under subsection (c)(2)(iii). If Bank B paid Beneficiary it is entitled to recover the payment except to the extent the law of mistake and restitution allows Beneficiary to retain payment. In this case Beneficiary might be entitled to retain $10,000, the amount of the debt owed to Beneficiary. If Beneficiary may retain $10,000, Bank B would be entitled to $10,000 from Bank A pursuant to subsection (f). In this case Originator also cancelled its order. Thus Bank A would be entitled to $10,000 from Originator pursuant to subsection (f).

5. Unless constrained by a funds transfer system rule, a receiving bank may agree to cancellation or amendment of the payment order under subsection (c) but is not required to do so regardless of the circumstances. If the receiving bank has incurred liability as a result of its acceptance of the sender's order, there are substantial risks in agreeing to cancellation or amendment. This is particularly true for a beneficiary's bank. Cancellation or amendment after acceptance by the beneficiary's bank can be made only in the four cases stated and the beneficiary's bank may not have any way of knowing whether the requirements of subsection (c) have been met or whether it will be able to recover payment from the beneficiary that received payment. Even with indemnity the beneficiary's bank may be reluctant to alienate its customer, the beneficiary, by denying the customer the funds. Subsection (c) leaves the decision to the beneficiary's bank unless the consent of the beneficiary's bank is not required under a funds transfer system rule or other interbank agreement. If a receiving bank agrees to cancellation or amendment under subsection (c)(1) or (2), it is automatically entitled to indemnification from the sender under subsection (f). The indemnification provision recognizes that a sender has no right to cancel a payment order after it is accepted by the receiving bank. If the receiving bank agrees to cancellation, it is doing so as an accommodation to the sender and it should not incur a risk of loss in doing so.

6. Acceptance by the receiving bank of a payment order issued by the sender is comparable to acceptance of an offer under the law of contracts. Under that law the death or legal incapacity of an offeror terminates the offer even though the offeree has no notice of the death or incapacity. Restatement Second, Contracts § 48. Comment a. to that section states that the "rule seems to be a relic of the obsolete view that a contract requires a 'meeting of minds,' and it is out of harmony with the modern doctrine that a manifestation of assent is effective without regard to actual mental assent." Subsection (g), which reverses the Restatement rule in the case of a payment order, is similar to Section 4-405(1) which applies to checks. Subsection (g) does not address the effect of the bankruptcy of the sender of a payment order before the order is accepted, but the principle of subsection (g) has been recognized in Bank of Marin v. England, 385 U.S. 99 (1966). Although Bankruptcy Code Section 542(c) may not have been drafted with wire transfers in mind, its language can be read to allow the receiving bank to charge the sender's account for the amount of the payment order if the receiving bank executed it in ignorance of the bankruptcy.

7. Subsection (d) deals with stale payment orders. Payment orders normally are executed on the execution date or the day after. An order issued to the beneficiary's bank is normally accepted on the payment date or the day after. If a payment order is not accepted on its execution or payment date or shortly thereafter, it is probable that there was some problem with the terms of the order or the sender did not have sufficient funds or credit to cover the amount of the order. Delayed acceptance of such an order is normally not contemplated, but the order may not have been cancelled by the sender. Subsection (d) provides for cancellation by operation of law to prevent an unexpected delayed acceptance.

8. A funds transfer system rule can govern rights and obligations between banks that are parties to payment orders transmitted over the system even if the rule conflicts with Article 4A. In some cases, however, a rule governing a transaction between two banks can affect a third party in an unacceptable way. Subsection (h) deals with such a case. A funds transfer system rule cannot allow cancellation of a payment order accepted by the beneficiary's bank if the rule conflicts with subsection (c)(2). Because rights of the beneficiary and the originator are directly affected by acceptance, subsection (c)(2) severely limits cancellation. These limitations cannot be altered by funds transfer system rule.

4-4.5-212. Liability and duty of receiving bank regarding unaccepted payment order. If a receiving bank fails to accept a payment order that it is obliged by express agreement to accept, the bank is liable for breach of the agreement to the extent provided in the agreement or in this article, but does not otherwise have any duty to accept a payment order or, before acceptance, to take any action, or refrain from taking action, with respect to the order except as provided in this article or by express agreement. Liability based on acceptance arises only when acceptance occurs as stated in section 4-4.5-209, and liability

is limited to that provided in this article. A receiving bank is not the agent of the sender or beneficiary of the payment order it accepts, or of any other party to the funds transfer, and the bank owes no duty to any party to the funds transfer except as provided in this article or by express agreement.

Source: L. 90: Entire article added, p. 352, § 1, effective January 1, 1991.

OFFICIAL COMMENT

With limited exceptions stated in this Article, the duties and obligations of receiving banks that carry out a funds transfer arise only as a result of acceptance of payment orders or of agreements made by receiving banks. Exceptions are stated in Section 4A-209(b)(3) and Section 4A-210(b). A receiving bank is not like a collecting bank under Article 4. No receiving bank, whether it be an originator's bank, an intermediary bank or a beneficiary's bank, is an agent for any other party in the funds transfer.

PART 3

EXECUTION OF SENDER'S PAYMENT ORDER BY RECEIVING BANK

4-4.5-301. Execution and execution date. (a) A payment order is "executed" by the receiving bank when it issues a payment order intended to carry out the payment order received by the bank. A payment order received by the beneficiary's bank can be accepted but cannot be executed.

(b) "Execution date" of a payment order means the day on which the receiving bank may properly issue a payment order in execution of the sender's order. The execution date may be determined by instruction of the sender but cannot be earlier than the day the order is received and, unless otherwise determined, is the day the order is received. If the sender's instruction states a payment date, the execution date is the payment date or an earlier date on which execution is reasonably necessary to allow payment to the beneficiary on the payment date.

Source: L. 90: Entire article added, p. 353, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. The terms "executed," "execution" and "execution date" are used only" with respect to a payment order to a receiving bank other than the beneficiary's bank. The beneficiary's bank can accept the payment order that it receives, but it does not execute the order. Execution refers to the act of the receiving bank in issuing a payment order "intended to carry out" the payment order that the bank received. A receiving bank has executed an order even if the order issued by the bank does not carry out the order received by the bank. For example, the bank may have erroneously issued an order to the wrong beneficiary, or in the wrong amount or to the wrong beneficiary's bank. In each of these cases execution has occurred but the execution is erroneous. Erroneous execution is covered in Section 4A-303.

2. "Execution date" refers to the time a payment order should be executed rather than the day it is actually executed. Normally the sender will not specify an execution date, but most payment orders are meant to be executed immediately. Thus, the execution date is normally the day the order is received by the receiving bank. It is common for the sender to specify a "payment date" which is defined in Section 4A-401 as "the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank." Except for automated clearing house transfers, if a funds transfer is entirely within the United States and the payment is to be carried out electronically, the execution date is the payment date unless the order is received after the payment date. If the payment is to be carried out through an automated clearing house, execution may occur before the payment date. In an ACH transfer the beneficiary is usually paid one or two days after issue of the originator's payment order. The execution date is determined by the stated payment date and is a date before the payment date on which execution is reasonably necessary to allow payment on the payment date. A funds

transfer system rule could also determine the execution date of orders received by the receiving bank if both the sender and the receiving bank are participants in the funds transfer system. The execution date can be determined by the payment order itself or by separate instructions of the sender or an agreement of the sender and the receiving bank. The second sentence of subsection (b) must be read in the light of Section 4A-106 which states that if a payment order is received after the cut-off time of the receiving bank it may be treated by the bank as received at the opening of the next funds transfer business day.

3. Execution on the execution date is timely, but the order can be executed before or after the execution date. Section 4A-209(d) and Section 4A-402(c) state the consequences of early execution and Section 4A-305(a) states the consequences of late execution.

4-4.5-302. Obligations of receiving bank in execution of payment order. (a) Except as provided in subsections (b) through (d) of this section, if the receiving bank accepts a payment order pursuant to section 4-4.5-209 (a), the bank has the following obligations in executing the order:

(1) The receiving bank is obliged to issue, on the execution date, a payment order complying with the sender's order and to follow the sender's instructions concerning (i) any intermediary bank or funds-transfer system to be used in carrying out the funds transfer, or (ii) the means by which payment orders are to be transmitted in the funds transfer. If the originator's bank issues a payment order to an intermediary bank, the originator's bank is obliged to instruct the intermediary bank according to the instruction of the originator. An intermediary bank in the funds transfer is similarly bound by an instruction given to it by the sender of the payment order it accepts.

(2) If the sender's instruction states that the funds transfer is to be carried out telephonically or by wire transfer or otherwise indicates that the funds transfer is to be carried out by the most expeditious means, the receiving bank is obliged to transmit its payment order by the most expeditious available means, and to instruct any intermediary bank accordingly. If a sender's instruction states a payment date, the receiving bank is obliged to transmit its payment order at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date or as soon thereafter as is feasible.

(b) Unless otherwise instructed, a receiving bank executing a payment order may (i) use any funds-transfer system if use of that system is reasonable in the circumstances, and (ii) issue a payment order to the beneficiary's bank or to an intermediary bank through which a payment order conforming to the sender's order can expeditiously be issued to the beneficiary's bank if the receiving bank exercises ordinary care in the selection of the intermediary bank. A receiving bank is not required to follow an instruction of the sender designating a funds-transfer system to be used in carrying out the funds transfer if the receiving bank, in good faith, determines that it is not feasible to follow the instruction or that following the instruction would unduly delay completion of the funds transfer.

(c) Unless subsection (a) (2) of this section applies or the receiving bank is otherwise instructed, the bank may execute a payment order by transmitting its payment order by first class mail or by any means reasonable in the circumstances. If the receiving bank is instructed to execute the sender's order by transmitting its payment order by a particular means, the receiving bank may issue its payment order by the means stated or by any means as expeditious as the means stated.

(d) Unless instructed by the sender, (i) the receiving bank may not obtain payment of its charges for services and expenses in connection with the execution of the sender's order by issuing a payment order in an amount equal to the amount of the sender's order less the amount of the charges, and (ii) may not instruct a subsequent receiving bank to obtain payment of its charges in the same manner.

Source: L. 90: Entire article added, p. 353, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. In the absence of agreement, the receiving bank is not obliged to execute an order of the sender. Section 4A-212. Section 4A-302 states the manner in which the receiving bank may execute the sender's order if execution occurs. Subsection (a) (1) states the residual rule. The

payment order issued by the receiving bank must comply with the sender's order and, unless some other rule is stated in the section, the receiving bank is obliged to follow any instruction of the sender concerning which funds transfer system is to be used, which intermediary banks are to be used, and what means of transmission is to be used. The instruction of the sender may be incorporated in the payment order itself or may be given separately. For example, there may be a master agreement between the sender and receiving bank containing instructions governing payment orders to be issued from time to time by the sender to the receiving bank. In most funds transfers, speed is a paramount consideration. A sender that wants assurance that the funds transfer will be expeditiously completed can specify the means to be used. The receiving bank can follow the instructions literally or it can use an equivalent means. For example, if the sender instructs the receiving bank to transmit by telex, the receiving bank could use telephone instead. Subsection (c). In most cases the sender will not specify a particular means but will use a general term such as "by wire" or "wire transfer" or "as soon as possible." These words signify that the sender wants a same-day transfer. In these cases the receiving bank is required to use a telephonic or electronic communication to transmit its order and is also required to instruct any intermediary bank to which it issues its order to transmit by similar means. Subsection (a) (2). In other cases, such as an automated clearing house transfer, a same-day transfer is not contemplated. Normally the sender's instruction or the context in which the payment order is received makes clear the type of funds transfer that is appropriate. If the sender states a payment date with respect to the payment order, the receiving bank is obliged to execute the order at a time and in a manner to meet the payment date if that is feasible. Subsection (a) (2). This provision would apply to many ACH transfers made to pay recurring debts of the sender. In other cases, involving relatively small amounts, time may not be an important factor and cost may be a more important element. Fast means, such as telephone or electronic transmission, are more expensive than slow means such as mailing. Subsection (c) states that in the absence of instructions the receiving bank is given discretion to decide. It may issue its payment order by first class mail or by any means reasonable in the circumstances. Section 4A-305 states the liability of a receiving bank for breach of the obligations stated in Section 4A-302.

2. Subsection (b) concerns the choice of intermediary banks to be used in completing the funds transfer, and the funds transfer system to be used. If the receiving bank is not instructed about the matter, it can issue an order directly to the beneficiary's bank or can issue an order to an intermediary bank. The receiving bank also has discretion concerning use of a funds transfer system. In some cases it may be reasonable to use either an automated clearing house system or a wire transfer system such as Fedwire or CHIPS. Normally, the receiving bank will follow the instruction of the sender in these matters, but in some cases it may be prudent for the bank not to follow instructions. The sender may have designated a funds transfer system to be used in carrying out the funds transfer, but it may not be feasible to use the designated system because of some impediment such as a computer breakdown which prevents prompt execution of the order. The receiving bank is permitted to use an alternate means of transmittal in a good faith effort to execute the order expeditiously. The same leeway is not given to the receiving bank if the sender designates an intermediary bank through which the funds transfer is to be routed. The sender's designation of that intermediary bank may mean that the beneficiary's bank is expecting to obtain a credit from that intermediary bank and may have relied on that anticipated credit. If the receiving bank uses another intermediary bank the expectations of the beneficiary's bank may not be realized. The receiving bank could choose to route the transfer to another intermediary bank and then to the designated intermediary bank if there were some reason such as a lack of a correspondent-bank relationship or a bilateral credit limitation, but the designated intermediary bank cannot be circumvented. To do so violates the sender's instructions.

3. The normal rule, under subsection (a) (1), is that the receiving bank, in executing a payment order, is required to issue a payment order that complies as to amount with that of the sender's order. In most cases the receiving bank issues an order equal to the amount of the sender's order and makes a separate charge for services and expenses in executing the sender's order. In some cases, particularly if it is an intermediary bank that is executing an order, charges are collected by deducting them from the amount of the payment order issued by the executing bank. If that is done, the amount of the payment order accepted by the beneficiary's bank will be slightly less than the amount of the originator's payment order. For example, Originator, in order to pay an obligation of $1,000,000 owed to Beneficiary, issues a payment order to Originator's Bank to pay $1,000,000 to the account of Beneficiary in Beneficiary's Bank. Originator's Bank issues a payment order to Intermediary Bank for $1,000,000 and debits Originator's account for $1,000,010. The extra $10 is the fee of Originator's Bank. Intermediary Bank executes the payment order of Originator's Bank by issuing a payment order to Beneficiary's Bank for $999,990, but under § 4A-402(c) is entitled to receive $1,000,000

from Originator's Bank. The $10 difference is the fee of Intermediary Bank. Beneficiary's Bank credits Beneficiary's account for $999,990. When Beneficiary's Bank accepts the payment order of Intermediary Bank the result is a payment of $999,990 from Originator to Beneficiary. Section 4A-406(a). If that payment discharges the $1,000,000 debt, the effect is that Beneficiary has paid the charges of Intermediary Bank and Originator has paid the charges of Originator's Bank. Subsection (d) of Section 4A-302 allows Intermediary Bank to collect its charges by deducting them from the amount of the payment order, but only if instructed to do so by Originator's Bank. Originator's Bank is not authorized to give that instruction to Intermediary Bank unless Originator authorized the instruction. Thus, Originator can control how the charges of Originator's Bank and Intermediary Bank are to be paid. Subsection (d) does not apply to charges of Beneficiary's Bank to Beneficiary.

In the case discussed in the preceding paragraph the $10 charge is trivial in relation to the amount of the payment and it may not be important to Beneficiary how the charge is paid. But it may be very important if the $1,000,000 obligation represented the price of exercising a right such as an option favorable to Originator and unfavorable to Beneficiary. Beneficiary might well argue that it was entitled to receive $1,000,000. If the option was exercised shortly before its expiration date, the result could be loss of the option benefit because the required payment of $1,000,000 was not made before the option expired. Section 4A-406(c) allows Originator to preserve the option benefit. The amount received by Beneficiary is deemed to be $1,000,000 unless Beneficiary demands the $10 and Originator does not pay it.

4-4.5-303. Erroneous execution of payment order. (a) A receiving bank that (i) executes the payment order of the sender by issuing a payment order in an amount greater than the amount of the sender's order, or (ii) issues a payment order in execution of the sender's order and then issues a duplicate order, is entitled to payment of the amount of the sender's order under section 4-4.5-402(c) if that subsection is otherwise satisfied. The bank is entitled to recover from the beneficiary of the erroneous order the excess payment received to the extent allowed by the law governing mistake and restitution.

(b) A receiving bank that executes the payment order of the sender by issuing a payment order in an amount less than the amount of the sender's order is entitled to payment of the amount of the sender's order under section 4-4.5-402(c) if (i) that subsection is otherwise satisfied and (ii) the bank corrects its mistake by issuing an additional payment order for the benefit of the beneficiary of the sender's order. If the error is not corrected, the issuer of the erroneous order is entitled to receive or retain payment from the sender of the order it accepted only to the extent of the amount of the erroneous order. This subsection (b) does not apply if the receiving bank executes the sender's payment order by issuing a payment order in an amount less than the amount of the sender's order for the purpose of obtaining payment of its charges for services and expenses pursuant to instruction of the sender.

(c) If a receiving bank executes the payment order of the sender by issuing a payment order to a beneficiary different from the beneficiary of the sender's order and the funds transfer is completed on the basis of that error, the sender of the payment order that was erroneously executed and all previous senders in the funds transfer are not obliged to pay the payment orders they issued. The issuer of the erroneous order is entitled to recover from the beneficiary of the order the payment received to the extent allowed by the law governing mistake and restitution.

Source: L. 90: Entire article added, p. 354, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. Section 4A-303 states the effect of erroneous execution of a payment order by the receiving bank. Under Section 4A-402(c) the sender of a payment order is obliged to pay the amount of the order to the receiving bank if the bank executes the order, but the obligation to pay is excused if the beneficiary's bank does not accept a payment order instructing payment to the beneficiary of the sender's order. If erroneous execution of the sender's order causes the wrong beneficiary to be paid, the sender is not required to pay. If erroneous execution causes the wrong amount to be paid the sender is not obliged to pay the receiving bank an amount in excess of the amount of the sender's order. Section 4A-303 takes precedence over Section

4A-402(c) and states the liability of the sender and the rights of the receiving bank in various cases of erroneous execution.

2. Subsections (a) and (b) deal with cases in which the receiving bank executes by issuing a payment order in the wrong amount. If Originator ordered Originator's Bank to pay $1,000,000 to the account of Beneficiary in Beneficiary's Bank, but Originator's Bank erroneously instructed Beneficiary's Bank to pay $2,000,000 to Beneficiary's account, subsection (a) applies. If Beneficiary's Bank accepts the order of Originator's Bank, Beneficiary's Bank is entitled to receive $2,000,000 from Originator's Bank, but Originator's Bank is entitled to receive only $1,000,000 from Originator. Originator's Bank is entitled to recover the overpayment from Beneficiary to the extent allowed by the law governing mistake and restitution. Originator's Bank would normally have a right to recover the overpayment from Beneficiary, but in unusual cases the law of restitution might allow Beneficiary to keep all or part of the overpayment. For example, if Originator owed $2,000,000 to Beneficiary and Beneficiary received the extra $1,000,000 in good faith in discharge of the debt, Beneficiary may be allowed to keep it. In this case Originator's Bank has paid an obligation of Originator and under the law of restitution, which applies through Section 1-103, Originator's Bank would be subrogated to Beneficiary's rights against Originator on the obligation paid by Originator's Bank.

If Originator's Bank erroneously executed Originator's order by instructing Beneficiary's Bank to pay less than $1,000,000, subsection (b) applies. If Originator's Bank corrects its error by issuing another payment order to Beneficiary's Bank that results in payment of $1,000,000 to Beneficiary, Originator's Bank is entitled to payment of $1,000,000 from Originator. If the mistake is not corrected, Originator's Bank is entitled to payment from Originator only in the amount of the order issued by Originator's Bank.

3. Subsection (a) also applies to duplicate payment orders. Assume Originator's Bank properly executes Originator's $1,000,000 payment order and then by mistake issues a second $1,000,000 payment order in execution of Originator's order. If Beneficiary's Bank accepts both orders issued by Originator's Bank, Beneficiary's Bank is entitled to receive $2,000,000 from Originator's Bank but Originator's Bank is entitled to receive only $1,000,000 from Originator. The remedy of Originator's Bank is the same as that of a receiving bank that executes by issuing an order in an amount greater than the sender's order. It may recover the overpayment from Beneficiary to the extent allowed by the law governing mistake and restitution and in a proper case as stated in Comment 2 may have subrogation rights if it is not entitled to recover from Beneficiary.

4. Suppose Originator instructs Originator's Bank to pay $1,000,000 to Account #12345 in Beneficiary's Bank. Originator's Bank erroneously instructs Beneficiary's Bank to pay $1,0000,000 to Account #12346 and Beneficiary's Bank accepted. Subsection (c) covers this case. Originator is not obliged to pay its payment order, but Originator's Bank is required to pay $1,000,000 to Beneficiary's Bank. The remedy of Originator's Bank is to recover $1,000,000 from the holder of Account #12346 that received payment by mistake. Recovery based on the law of mistake and restitution is described in Comment 2.

4-4.5-304. Duty of sender to report erroneously executed payment order. If the sender of a payment order that is erroneously executed as stated in section 4-4.5-303 receives notification from the receiving bank that the order was executed or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care to determine, on the basis of information available to the sender, that the order was erroneously executed and to notify the bank of the relevant facts within a reasonable time not exceeding ninety days after the notification from the bank was received by the sender. If the sender fails to perform that duty, the bank is not obliged to pay interest on any amount refundable to the sender under section 4-4.5-402(d) for the period before the bank learns of the execution error. The bank is not entitled to any recovery from the sender on account of a failure by the sender to perform the duty stated in this section.

Source: L. 90: Entire article added, p. 355, § 1, effective January 1, 1991.

OFFICIAL COMMENT

This section is identical in effect to Section 4A-204 which applies to unauthorized orders issued in the name of a customer of the receiving bank. The rationale is stated in Comment 2 to Section 4A-204.

4-4.5-305. Liability for late or improper execution or failure to execute payment order. (a) If a funds transfer is completed but execution of a payment order by the receiving bank in breach of section 4-4.5-302 results in delay in payment to the beneficiary, the bank is obliged to pay interest to either the originator or the beneficiary of the funds transfer for the period of delay caused by the improper execution. Except as provided in subsection (c), of this section, additional damages are not recoverable.

(b) If execution of a payment order by a receiving bank in breach of section 4-4.5-302 results in (i) noncompletion of the funds transfer, (ii) failure to use an intermediary bank designated by the originator, or (iii) issuance of a payment order that does not comply with the terms of the payment order of the originator, the bank is liable to the originator for its expenses in the funds transfer and for incidental expenses and interest losses, to the extent not covered by subsection (a) of this section, resulting from the improper execution. Except as provided in subsection (c) of this section, additional damages are not recoverable.

(c) In addition to the amounts payable under subsections (a) and (b) of this section, damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank.

(d) If a receiving bank fails to execute a payment order it was obliged by express agreement to execute, the receiving bank is liable to the sender for its expenses in the transaction and for incidental expenses and interest losses resulting from the failure to execute. Additional damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank, but are not otherwise recoverable.

(e) Reasonable attorney's fees are recoverable if demand for compensation under subsection (a) or (b) of this section is made and refused before an action is brought on the claim. If a claim is made for breach of an agreement under subsection (d) of this section and the agreement does not provide for damages, reasonable attorney's fees are recoverable if demand for compensation under subsection (d) of this section is made and refused before an action is brought on the claim.

(f) Except as stated in this section, the liability of a receiving bank under subsections (a) and (b) of this section may not be varied by agreement.

Source: L. 90: Entire article added, p. 355, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. Subsection (a) covers cases of delay in completion of a funds transfer resulting from an execution by a receiving bank in breach of Section 4A-302(a). The receiving bank is obliged to pay interest on the amount of the order for the period of the delay. The rate of interest is stated in Section 4A-506. With respect to wire transfers (other than ACH transactions) within the United States, the expectation is that the funds transfer will be completed the same day. In those cases, the originator can reasonably expect that the originator's account will be debited on the same day as the beneficiary's account is credited. If the funds transfer is delayed, compensation can be paid either to the originator or to the beneficiary. The normal practice is to compensate the beneficiary's bank to allow that bank to compensate the beneficiary by back-valuing the payment by the number of days of delay. Thus, the beneficiary is in the same position that it would have been in if the funds transfer had been completed on the same day. Assume on Day 1, Originator's Bank issues its payment order to Intermediary Bank which is received on that day. Intermediary Bank does not execute that order until Day 2 when it issues an order to Beneficiary's Bank which is accepted on that day. Intermediary Bank complies with subsection (a) by paying one day's interest to Beneficiary's Bank for the account of Beneficiary.

2. Subsection (b) applies to cases of breach of Section 4A-302 involving more than mere delay. In those cases the bank is liable for damages for improper execution but they are limited to compensation for interest losses and incidental expenses of the sender resulting from the reach, the expenses of the sender in the funds transfer and attorney's fees. This subsection reflects the judgment that imposition of consequential damages on a bank for commission of an error is not justified.

The leading common law case on the subject of consequential damages is Evra Corp. v. Swiss Bank Corp., 673 F.2d 951 (7th Cir. 1982), in which Swiss Bank, an intermediary bank, failed to execute a payment order. Because the beneficiary did not receive timely payment the orig-

inator lost a valuable ship charter. The lower court awarded the originator $2.1 million for lost profits even though the amount of the payment order was only $27,000. The Seventh Circuit reversed, in part on the basis of the common law rule of Hadley v. Baxendale that consequential damages may not be awarded unless the defendant is put on notice of the special circumstances giving rise to them. Swiss Bank may have known that the originator was paying the shipowner for the hire of a vessel but did not know that a favorable charter would be lost if the payment as delayed. "Electronic payments are not so unusual as to automatically place a bank on notice of extraordinary consequences if such a transfer goes awry. Swiss Bank did not have enough information to infer that if it lost a $27,000 payment order it would face liability in excess of $2 million." 673 F.2d at 956.

If Evra means that consequential damages can be imposed if the culpable bank has notice of particular circumstances giving rise to the damages, it does not provide an acceptable solution to the problem of bank liability for consequential damages. In the typical case transmission of the payment order is made electronically. Personnel of the receiving bank that process payment orders are not the appropriate people to evaluate the risk of liability for consequential damages in relation to the price charged for the wire transfer service. Even if notice is received by higher level management personnel who could make an appropriate decision whether the risk is justified by the price, liability based on notice would require evaluation of payment orders on an individual basis. This kind of evaluation is inconsistent with the high-speed, low-price, mechanical nature of the processing system that characterizes wire transfers. Moreover, in Evra the culpable bank was an intermediary bank with which the originator did not deal. Notice to the originator's bank would not bind the intermediary bank, and it seems impractical for the originator's bank to convey notice of this kind to intermediary banks in the funds transfer. The success of the wholesale wire transfer industry has largely been based on its ability to effect payment at low cost and great speed. Both of these essential aspects of the modern wire transfer system would be adversely affected by a rule that imposed on banks liability for consequential damages. A banking industry amicus brief in Evra stated: "Whether banks can continue to make EFT services available on a widespread basis, by charging reasonable rates, depends on whether they can do so without incurring unlimited consequential risks. Certainly, no bank would handle for $3.25, a transaction entailing potential liability in the millions of dollars."

As the court in Evra also noted, the originator of the funds transfer is in the best position to evaluate the risk that a funds transfer will not be made on time and to manage that risk by issuing a payment order in time to allow monitoring of the transaction. The originator, by asking the beneficiary, can quickly determine if the funds transfer has been completed. If the originator has sent the payment order at a time that allows a reasonable margin for correcting error, no loss is likely to result if the transaction is monitored. The other published cases on this issue reach the Evra result. Central Coordinates, Inc. v. Morgan Guaranty Trust Co., 40 U.C.C. Rep. Serv. 1340 (N.Y.Sup.Ct. 1985), and Gatoil (U.S.A.), Inc. v. Forest Hill State Bank, 1 U.C.C. Rep.Serv. 2d 171 (D.Md. 1986).

Subsection (c) allows the measure of damages in subsection (b) to be increased by an express written agreement of the receiving bank. An originator's bank might be willing to assume additional responsibilities and incur additional liability in exchange for a higher fee.

3. Subsection (d) governs cases in which a receiving bank has obligated itself by express agreement to accept payment orders of a sender. In the absence of such an agreement there is no obligation by a receiving bank to accept a payment order. Section 4A-212. The measure of damages for breach of an agreement to accept a payment order is the same as that stated in subsection (b). As in the case of subsection (b), additional damages, including consequential damages, may be recovered to the extent stated in an express written agreement of the receiving bank.

4. Reasonable attorney's fees are recoverable only in cases in which damages are limited to statutory damages stated in subsection (a), (b) and (d). If additional damages are recoverable because provided for by an express written agreement, attorney's fees are not recoverable. The rationale is that there is no need for statutory attorney's fees in the latter case, because the parties have agreed to a measure of damages which may or may not provide for attorney's fees.

5. The effect of subsection (f) is to prevent reduction of a receiving bank's liability under Section 4A-305.

PART 4

PAYMENT

4-4.5-401. Payment date. "Payment date" of a payment order means the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank. The payment

date may be determined by instruction of the sender but cannot be earlier than the day the order is received by the beneficiary's bank and, unless otherwise determined, is the day the order is received by the beneficiary's bank.

Source: L. 90: Entire article added, p. 356, § 1, effective January 1, 1991.

OFFICIAL COMMENT

"Payment date" refers to the day the beneficiary's bank is to pay the beneficiary. The payment date may be expressed in various ways so long as it indicates the day the beneficiary is to receive payment. For example, in ACH transfers the payment date is the equivalent of "settlement date" or "effective date." Payment date applies to the payment order issued to the beneficiary's bank, but a payment order issued to a receiving bank other than the beneficiary's bank may also state a date for payment to the beneficiary. In the latter case, the statement of a payment date is to instruct the receiving bank concerning time of execution of the sender's order. Section 4A-301(b).

4-4.5-402. Obligation of sender to pay receiving bank. (a) This section is subject to sections 4-4.5-205 and 4-4.5-207.

(b) With respect to a payment order issued to the beneficiary's bank, acceptance of the order by the bank obliges the sender to pay the bank the amount of the order, but payment is not due until the payment date of the order.

(c) This subsection (c) is subject to subsection (e) of this section and to section 4-4.5-303. With respect to a payment order issued to a receiving bank other than the beneficiary's bank, acceptance of the order by the receiving bank obliges the sender to pay the bank the amount of the sender's order. Payment by the sender is not due until the execution date of the sender's order. The obligation of that sender to pay its payment order is excused if the funds transfer is not completed by acceptance by the beneficiary's bank of a payment order instructing payment to the beneficiary of that sender's payment order.

(d) If the sender of a payment order pays the order and was not obliged to pay all or part of the amount paid, the bank receiving payment is obliged to refund payment to the extent the sender was not obliged to pay. Except as provided in sections 4-4.5-204 and 4-4.5-304, interest is payable on the refundable amount from the date of payment.

(e) If a funds transfer is not completed as stated in subsection (c) of this section and an intermediary bank is obliged to refund payment as stated in subsection (d) of this section but is unable to do so because not permitted by applicable law or because the bank suspends payments, a sender in the funds transfer that executed a payment order in compliance with an instruction, as stated in section 4-4.5-302(a) (1), to route the funds transfer through that intermediary bank is entitled to receive or retain payment from the sender of the payment order that it accepted. The first sender in the funds transfer that issued an instruction requiring routing through that intermediary bank is subrogated to the right of the bank that paid the intermediary bank to refund as stated in subsection (d) of this section.

(f) The right of the sender of a payment order to be excused from the obligation to pay the order as stated in subsection (c) of this section or to receive refund under subsection (d) of this section may not be varied by agreement.

Source: L. 90: Entire article added, p. 356, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. Subsection (b) states that the sender of a payment order to the beneficiary's bank must pay the order when the beneficiary's bank accepts the order. At that point the beneficiary's bank is obliged to pay the beneficiary. Section 4A-404(a). The last clause of subsection (b) covers a case of premature acceptance by the beneficiary's bank. In some funds transfers, notably automated clearing house transfers, a beneficiary's bank may receive a payment order with a payment date after the day the order is received. The beneficiary's bank might accept the order before the payment date by notifying the beneficiary of receipt of the order. Although the acceptance obliges the beneficiary's bank to pay the beneficiary, payment is not due until the

payment date. The last clause of subsection (b) is consistent with that result. The beneficiary's bank is also not entitled to payment from the sender until the payment date.

2. Assume that Originator instructs Bank A to order immediate payment to the account of Beneficiary in Bank B. Execution of Originator's payment order by Bank A is acceptance under Section 4A-209(a), Under the second sentence of Section 4A-402(c) the acceptance creates an obligation of Originator to pay Bank A the amount of the order. The last clause of that sentence deals with attempted funds transfers that are not completed. In that event the obligation of the sender to pay its payment order is excused. Originator makes payment to Beneficiary when Bank B, the beneficiary's bank, accepts a payment order for the benefit of Beneficiary. Section 4A-406(a). If that acceptance by Bank B does not occur, the funds transfer has miscarried because Originator has not paid Beneficiary. Originator doesn't have to pay its payment order, and if it has already paid it is entitled to refund of the payment with interest. The rate of interest is stated in Section 4A-506. This "money-back guarantee" is an important protection of Originator. Originator is assured that it will not lose its money if something goes wrong in the transfer. For example, risk of loss resulting from payment to the wrong beneficiary is borne by some bank, not by Originator. The most likely reason for noncompletion is a failure to execute or an erroneous execution of a payment order by Bank A or an intermediary bank. Bank A may have issued its payment order to the wrong bank or it may have identified the wrong beneficiary in its order. The money-back guarantee is particularly important to Originator if noncompletion of the funds transfer is due to the fault of an intermediary bank rather than Bank A. In that case Bank A must refund payment to Originator, and Bank A has the burden of obtaining refund from the intermediary bank that it paid.

Subsection (c) can result in loss if an intermediary bank suspends payments. Suppose Originator instructs Bank A to pay to Beneficiary's account in Bank B and to use Bank C as an intermediary bank. Bank A executes Originator's order by issuing a payment order to Bank C. Bank A pays Bank C. Bank C fails to execute the order of Bank A and suspends payments. Under subsections (c) and (d), Originator is not obliged to pay Bank A and is entitled to refund from Bank A of any payment that it may have made. Bank A is entitled to a refund from Bank C, but Bank C is insolvent. Subsection (e) deals with this case. Bank A was required to issue its payment order to Bank C because Bank C was designated as an intermediary bank by Originator. Section 4A-302(a)(1). In this case Originator takes the risk of insolvency of Bank C. Under subsection (e) Bank A is entitled to payment from Originator and Originator is subrogated to the right of Bank A under subsection (d) to refund of payment from Bank C.

3. A payment order is not like a negotiable instrument on which the drawer or maker has liability. Acceptance of the order by the receiving bank creates an obligation of the sender to pay the receiving bank the amount of the order. That is the extent of the sender's liability to the receiving bank and no other person has any rights against the sender with respect to the sender's order.

4-4.5-403. Payment by sender to receiving bank. (a) Payment of the sender's obligation under section 4-4.5-402 to pay the receiving bank occurs as follows:

(1) If the sender is a bank, payment occurs when the receiving bank receives final settlement of the obligation through a federal reserve bank or through a funds-transfer system.

(2) If the sender is a bank and the sender (i) credited an account of the receiving bank with the sender, or (ii) caused an account of the receiving bank in another bank to be credited, payment occurs when the credit is withdrawn or, if not withdrawn, at midnight of the day on which the credit is withdrawable and the receiving bank learns of that fact.

(3) If the receiving bank debits an account of the sender with the receiving bank, payment occurs when the debit is made to the extent the debit is covered by a withdrawable credit balance in the account.

(b) If the sender and receiving bank are members of a funds-transfer system that nets obligations multilaterally among participants, the receiving bank receives final settlement when settlement is complete in accordance with the rules of the system. The obligation of the sender to pay the amount of a payment order transmitted through the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against the sender's obligation the right of the sender to receive payment from the receiving bank of the amount of any other payment order transmitted to the sender by the receiving bank through the funds-transfer system. The aggregate balance of obligations owed by each sender to each receiving bank in the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against that

balance the aggregate balance of obligations owed to the sender by other members of the system. The aggregate balance is determined after the right of setoff stated in the second sentence of this subsection (b) has been exercised.

(c) If two banks transmit payment orders to each other under an agreement that settlement of the obligations of each bank to the other under section 4-4.5-402 will be made at the end of the day or other period, the total amount owed with respect to all orders transmitted by one bank shall be set off against the total amount owed with respect to all orders transmitted by the other bank. To the extent of the setoff, each bank has made payment to the other.

(d) In a case not covered by subsection (a) of this section, the time when payment of the sender's obligation under section 4-4.5-402(b) or 4-4.5-402(c) occurs is governed by applicable principles of law that determine when an obligation is satisfied.

Source: L. 90: Entire article added, p. 356, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. This section defines when a sender pays the obligation stated in Section 4A-402. If a group of two or more banks engage in funds transfers with each other, the participating banks will sometimes be senders and sometimes receiving banks. With respect to payment orders other than Fedwires, the amounts of the various payment orders may be credited and debited to accounts of one bank with another or to a clearing house account of each bank and amounts owed and amounts due are netted. Settlement is made through a Federal Reserve Bank by charges to the Federal Reserve accounts of the net debtor banks and credits to the Federal Reserve accounts of the net creditor banks. In the case of Fedwires the sender's obligation is settled by a debit to the Federal Reserve account of the sender and a credit to the Federal Reserve account of the receiving bank at the time the receiving bank receives the payment order. Both of these cases are covered by subsection (a) (1). When the Federal Reserve settlement becomes final the obligation of the sender under Section 4A-402 is paid.

2. In some cases a bank does not settle an obligation owed to another bank through a Federal Reserve Bank. This is the case if one of the banks is a foreign bank without access to the Federal Reserve payment system. In this kind of case, payment is usually made by credits or debits to accounts of the two banks with each other or to accounts of the two banks in a third bank. Suppose Bank B has an account in Bank A. Bank A advises Bank B that its account in Bank A has been credited $1,000,000 and that the credit is immediately withdrawable. Bank A also instructs Bank B to pay $1,000,000 to the account of Beneficiary in Bank B. This case is covered by subsection (a) (2). Bank B may want to immediately withdraw this credit. For example, it might do so by instructing Bank A to debit the account and pay some third party. Payment by Bank A to Bank B of Bank A's payment order occurs when the withdrawal is made. Suppose Bank B does not withdraw the credit. Since Bank B is the beneficiary's bank, one of the effects of receipt of payment by Bank B is that acceptance of Bank A's payment order automatically occurs at the time of payment. Section 4A-209(b)(2). Acceptance means that Bank B is obliged to pay $1,000,000 to Beneficiary. Section 4A-404(a). Subsection (a) (2) of Section 4A-403 states that payment does not occur until midnight if the credit is not withdrawn. This allows Bank B an opportunity to reject the order if it does not have time to withdraw the credit to its account and it is not willing to incur the liability to Beneficiary before it has use of the funds represented by the credit.

3. Subsection (a) (3) applies to a case in which the sender (bank or nonbank) has a funded account in the receiving bank. If Sender has an account in Bank and issues a payment order to Bank, Bank can obtain payment from Sender by debiting the account of Sender, which pays its Section 4A-402 obligation to Bank when the debit is made.

4. Subsection (b) deals with multilateral settlements made through a funds transfer system and is based on the CHIPS settlement system. In a funds transfer system such as CHIPS, which allows the various banks that transmit payment orders over the system to settle obligations at the end of each day, settlement is not based on individual payment orders. Each bank using the system engages in funds transfers with many other banks using the system. Settlement for any participant is based on the net credit or debit position of that participant with all other banks using the system. Subsection (b) is designed to make clear that the obligations of any sender are paid when the net position of that sender is settled in accordance with the rules of the funds transfer system. This provision is intended to invalidate any argument, based on common-law principles, that multilateral netting is not valid because mutuality of obligation is not present. Subsection (b) dispenses with any

mutuality of obligation requirements. Subsection (c) applies to cases in which two banks send payment orders to each other during the day and settle with each other at the end of the day or at the end of some other period. It is similar to subsection (b) in that it recognizes that a sender's obligation to pay a payment order is satisfied by a setoff. The obligations of each bank as sender to the other as receiving bank are obligations of the bank itself and not as representative of customers. These two sections are important in the case of insolvency of a bank. They make clear that liability under Section 4A-02 is based on the net position of the insolvent bank after setoff.

5. Subsection (d) relates to the uncommon case in which the sender doesn't have an account relationship with the receiving bank and doesn't settle through a Federal Reserve Bank. An example would be a customer that pays over the counter for a payment order that the customer issues to the receiving bank. Payment would normally be by cash, check or bank obligation. When payment occurs is determined by law outside Article 4A.

4-4.5-404. Obligation of beneficiary's bank to pay and give notice to beneficiary. (a) Subject to sections 4-4.5-211 (e), 4-4.5-405 (d), and 4-4.5-405 (e), if a beneficiary's bank accepts a payment order, the bank is obliged to pay the amount of the order to the beneficiary of the order. Payment is due on the payment date of the order, but if acceptance occurs on the payment date after the close of the funds-transfer business day of the bank, payment is due on the next funds-transfer business day. If the bank refuses to pay after demand by the beneficiary and receipt of notice of particular circumstances that will give rise to consequential damages as a result of nonpayment, the beneficiary may recover damages resulting from the refusal to pay to the extent the bank had notice of the damages, unless the bank proves that it did not pay because of a reasonable doubt concerning the right of the beneficiary to payment.

(b) If a payment order accepted by the beneficiary's bank instructs payment to an account of the beneficiary, the bank is obliged to notify the beneficiary of receipt of the order before midnight of the next funds-transfer business day following the payment date. If the payment order does not instruct payment to an account of the beneficiary, the bank is required to notify the beneficiary only if notice is required by the order. Notice may be given by first class mail or any other means reasonable in the circumstances. If the bank fails to give the required notice, the bank is obliged to pay interest to the beneficiary on the amount of the payment order from the day notice should have been given until the day the beneficiary learned of receipt of the payment order by the bank. No other damages are recoverable. Reasonable attorney's fees are also recoverable if demand for interest is made and refused before an action is brought on the claim.

(c) The right of a beneficiary to receive payment and damages as stated in subsection (a) of this section may not be varied by agreement or a funds-transfer system rule. The right of a beneficiary to be notified as stated in subsection (b) of this section may be varied by agreement of the beneficiary or by a funds-transfer system rule if the beneficiary is notified of the rule before initiation of the funds transfer.

Source: L. 90: Entire article added, p. 357, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. The first sentence of subsection (a) states the time when the obligation of the beneficiary's bank arises. The second and third sentences state when the beneficiary's bank must make funds available to the beneficiary. They also state the measure of damages for failure, after demand, to comply. Since the Expedited Funds Availability Act, 12 U.S.C. 4001 et seq., also governs funds availability in a funds transfer, the second and third sentences of subsection (a) may be subject to preemption by that Act.

2. Subsection (a) provides that the beneficiary of an accepted payment order may recover consequential damages if the beneficiary's bank refuses to pay the order after demand by the beneficiary if the bank at that time had notice of the particular circumstances giving rise to the damages. Such damages are recoverable only to the extent the bank had "notice of the damages." The quoted phrase requires that the bank have notice of the general type or nature of the damages that will be suffered as a result of the refusal to pay and their general magnitude. There is no requirement that the bank have notice of the exact or even the approximate amount of the damages, but if the amount of damages is extraordinary the bank is entitled to notice of that fact. For example, in Evra Corp. v.

Swiss Bank Corp., 673 F.2d 951 (7th Cir. 1982), failure to complete a funds transfer of only $27,000 required to retain rights to a very favorable ship charter resulted in a claim for more than $2,000,000 of consequential damages. Since it is not reasonably foreseeable that a failure to make a relatively small payment will result in damages of this magnitude, notice is not sufficient if the beneficiary's bank has notice only that the $27,000 is necessary to retain rights on a ship charter. The bank is entitled to notice that an exceptional amount of damages will result as well. For example, there would be adequate notice if the bank had been made aware that damages of $1,000,000 or more might result.

3. Under the last clause of subsection (a) the beneficiary's bank is not liable for damages if its refusal to pay was "because of a reasonable doubt concerning the right of the beneficiary to payment". Normally there will not be any question about the right of the beneficiary to receive payment". Normally, the bank should be able to determine whether it has accepted the payment order and, if it has been accepted, the first sentence of subsection (a) states that the bank is obliged to pay. There may be uncommon cases, however, in which there is doubt whether acceptance occurred. For example, if acceptance is based on receipt of payment by the beneficiary's bank under Section 4A-403 (a) (I) or (2), there may be cases in which the bank is not certain that payment has been received. There may also be cases in which there is doubt about whether the person demanding payment is the person identified in the payment order as beneficiary of the order.

The last clause of subsection (a) does not apply to cases in which a funds transfer is being used to pay an obligation and a dispute arises between the originator and the beneficiary concerning whether the obligation is in fact owed. For example, the originator may try to prevent payment to the beneficiary by the beneficiary's bank by alleging that the beneficiary is not entitled to payment because of fraud against the originator or a breach of contract relating to the obligation. The fraud or breach of contract claim of the originator may be grounds for recovery by the originator from the beneficiary after the beneficiary is paid, but it does not affect the obligation of the beneficiary's bank to pay the beneficiary. Unless the payment order has been cancelled pursuant to Section 4A-211 (c) there is no excuse for refusing to pay the beneficiary and, in a proper case, the refusal may result in consequential damages. Except in the case of a book transfer, in which the beneficiary's bank is also the originator's bank, the originator of a funds transfer cannot cancel a payment order to the beneficiary's bank, with or without the consent of that bank, because the originator is not the sender of that order. Thus, the beneficiary's bank may safely ignore any instruction by the originator to withhold payment to the beneficiary.

4. Subsection (b) states the duty of the beneficiary's bank to notify the beneficiary of receipt of the order. If acceptance occurs under Section 4A-209(b)(1) the beneficiary is normally notified. Thus, subsection (b) applies primarily to cases in which acceptance occurs under Section 4A-209(b)(2) or (3). Notice under subsection (b) is not required if the person entitled to the notice agrees or a funds transfer system rule provides that notice is not required and the beneficiary is given notice of the rule. In ACH transactions the normal practice is not to give notice to the beneficiary unless notice is requested by the beneficiary. This practice can be continued by adoption of a funds transfer system rule. Subsection (a) is not subject to variation by agreement or by a funds transfer system rule.

4-4.5-405. Payment by beneficiary's bank to beneficiary. (a) If the beneficiary's bank credits an account of the beneficiary of a payment order, payment of the bank's obligation under section 4-4.5-404(a) occurs when and to the extent (i) the beneficiary is notified of the right to withdraw the credit, (ii) the bank lawfully applies the credit to a debt of the beneficiary, or (iii) funds with respect to the order are otherwise made available to the beneficiary by the bank.

(b) If the beneficiary's bank does not credit an account of the beneficiary of a payment order, the time when payment of the bank's obligation under section 4-4.5-404(a) occurs is governed by principles of law that determine when an obligation is satisfied.

(c) Except as stated in subsections (d) and (e) of this section, if the beneficiary's bank pays the beneficiary of a payment order under a condition to payment or agreement of the beneficiary giving the bank the right to recover payment from the beneficiary if the bank does not receive payment of the order, the condition to payment or agreement is not enforceable.

(d) A funds-transfer system rule may provide that payments made to beneficiaries of funds transfers made through the system are provisional until receipt of payment by the beneficiary's bank of the payment order it accepted. A beneficiary's bank that makes a payment that is provisional under the rule is entitled to refund from the beneficiary if (i) the

rule requires that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated, (ii) the beneficiary, the beneficiary's bank and the originator's bank agreed to be bound by the rule, and (iii) the beneficiary's bank did not receive payment of the payment order that it accepted. If the beneficiary is obliged to refund payment to the beneficiary's bank, acceptance of the payment order by the beneficiary's bank is nullified and no payment by the originator of the funds transfer to the beneficiary occurs under section 4-4.5-406.

(e) This subsection (e) applies to a funds transfer that includes a payment order transmitted over a funds-transfer system that (i) nets obligations multilaterally among participants, and (ii) has in effect a loss-sharing agreement among participants for the purpose of providing funds necessary to complete settlement of the obligations of one or more participants that do not meet their settlement obligations. If the beneficiary's bank in the funds transfer accepts a payment order and the system fails to complete settlement pursuant to its rules with respect to any payment order in the funds transfer, (i) the acceptance by the beneficiary's bank is nullified and no person has any right or obligation based on the acceptance, (ii) the beneficiary's bank is entitled to recover payment from the beneficiary, (iii) no payment by the originator to the beneficiary occurs under section 4-4.5-406, and (iv) subject to section 4-4.5-402(e), each sender in the funds transfer is excused from its obligation to pay its payment order under section 4-4.5-402(c) because the funds transfer has not been completed.

Source: L. 90: Entire article added, p. 358, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. This section defines when the beneficiary's bank pays the beneficiary and when the obligation of the beneficiary's bank under section 4A-404 to pay the beneficiary is satisfied. In almost all cases the bank will credit an account of the beneficiary when it receives a payment order. In the typical case the beneficiary is paid when the beneficiary is given notice of the right to withdraw the credit. Subsection (a) (i). In some cases payment might be made to the beneficiary not by releasing funds to the beneficiary, but by applying the credit to a debt of the beneficiary. Subsection (a) (ii). In this case the beneficiary gets the benefit of the payment order because a debt of the beneficiary has been satisfied. The two principal cases in which payment will occur in this manner are setoff by the beneficiary's bank and payment of the proceeds of the payment order to a garnishing creditor of the beneficiary. These cases are discussed in Comment 2 to Section 4A-502.

2. If a beneficiary's bank releases funds to the beneficiary before it receives payment from the sender of the payment order, it assumes the risk that the sender may not pay the sender's order because of suspension of payments or other reason. Subsection (c). As stated in Comment 5 to Section 4A-209, the beneficiary's bank can protect itself against this risk by delaying acceptance. But if the bank accepts the order it is obliged to pay the beneficiary. If the beneficiary's bank has given the beneficiary notice of the right to withdraw a credit made to the beneficiary's account, the beneficiary has received payment from the bank. Once payment has been made to the beneficiary with respect to an obligation incurred by the bank under Section 4A-404(a) the payment cannot be recovered by the beneficiary's bank unless subsection (d) or (e) applies. Thus, a right to withdraw a credit cannot be revoked if the right to withdraw constituted payment of the bank's obligation. This principle applies even if funds were released as a "loan" (see Comment 5 to Section 4A-209), or were released subject to a condition that they would be repaid in the event the bank does not receive payment from the sender of the payment order, or the beneficiary agreed to return the payment if the bank did not receive payment from the sender.

3. Subsection (c) is subject to an exception stated in subsection (d) which is intended to apply to automated clearing house transfers. ACH transfers are made in batches. A beneficiary's bank will normally accept, at the same time and as part of a single batch, payment orders with respect to many different originator's banks. Comment 2 to Section 4A-206. The custom in ACH transactions is to release funds to the beneficiary early on the payment date even though settlement to the beneficiary's bank does not occur until later in the day. The understanding is that payments to beneficiaries are provisional until the beneficiary's bank receives settlement. This practice is similar to what happens when a depositary bank releases funds with respect to a check forwarded for collection. If the check is dishonored the bank is entitled to recover the funds from the customer. ACH transfers are widely perceived as check substitutes.

Section 4A-405(d) allows the funds transfer system to adopt a rule making payments to beneficiaries provisional. If such a rule is adopted, a beneficiary's bank that releases funds to the beneficiary will be able to recover the payment if it doesn't receive payment of the payment order that it accepted. There are two requirements with respect to the funds transfer system rule. The beneficiary, the beneficiary's bank and the originator's bank must all agree to be bound by the rule and the rule must require that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated. There is no requirement that the notice be given with respect to a particular funds transfer. Once notice of the provisional nature of the payment has been given, the notice is effective for all subsequent payments to or from the person to whom the notice was given. Subsection (d) provides only that the funds transfer system rule must require notice to the beneficiary and the originator. The beneficiary's bank will know what the rule requires, but it has no way of knowing whether the originator's bank complied with the rule. Subsection (d) does not require proof that the originator received notice. If the originator's bank failed to give the required notice and the originator suffered as a result, the appropriate remedy is an action by the originator against the originator's bank based on that failure. But the beneficiary's bank will not be able to get the benefit of subsection (d) unless the beneficiary had notice of the provisional nature of the payment because subsection (d) requires an agreement by the beneficiary to be bound by the rule. Implicit in an agreement to be bound by a rule that makes a payment provisional is a requirement that notice be given of what the rule provides. The notice can be part of the agreement or separately given. For example, notice can be given by providing a copy of the system's operating rules.

With respect to ACH transfers made through a Federal Reserve Bank acting as an intermediary bank, the Federal Reserve Bank is obliged under Section 4A-402(b) to pay a beneficiary's bank that accepts the payment order. Unlike Fedwire transfers, under current ACH practice a Federal Reserve Bank that processes a payment order does not obligate itself to pay if the originator's bank fails to pay the Federal Reserve Bank. It is assumed that the Federal Reserve will use its right of preemption which is recognized in Section 4A-107 to disclaim the Section 4A-402(b) obligation in ACH transactions if it decides to retain the provisional payment rule.

4. Subsection (e) is another exception to subsection (c). It refers to funds transfer systems having loss-sharing rules described in the subsection. CHIPS has proposed a rule that fits the description. Under the CHIPS loss-sharing rule the CHIPS banks will have agreed to contribute funds to allow the system to settle for payment orders sent over the system during the day in the event that one or more banks are unable to meet their settlement obligations. Subsection (e) applies only if CHIPS fails to settle despite the loss-sharing rule. Since funds under the loss-sharing rule will be instantly available to CHIPS and will be in an amount sufficient to cover any failure that can be reasonably anticipated, it is extremely unlikely that CHIPS would ever fail to settle. Thus, subsection (e) addresses an event that should never occur. If that event were to occur, all payment orders made over the system would be cancelled under the CHIPS rule. Thus, no bank would receive settlement, whether or not a failed bank was involved in a particular funds transfer. Subsection (e) provides that each funds transfer in which there is a payment order with respect to which there is a settlement failure is unwound. Acceptance by the beneficiary's bank in each funds transfer is nullified. The consequences of nullification are that the beneficiary has no right to receive or retain payment by the beneficiary's bank, no payment is made by the originator to the beneficiary and each sender in the funds transfer is, subject to Section 4A-402(e), not obliged to pay its payment order and is entitled to refund under Section 4A-402(d) if it has already paid.

4-4.5-406. Payment by originator to beneficiary; discharge of underlying obligation. (a) Subject to sections 4-4.5-211(e), 4-4.5-405(d), and 4-4.5-405(e), the originator of a funds transfer pays the beneficiary of the originator's payment order (i) at the time a payment order for the benefit of the beneficiary is accepted by the beneficiary's bank in the funds transfer and (ii) in an amount equal to the amount of the order accepted by the beneficiary's bank, but not more than the amount of the originator's order.

(b) If payment under subsection (a) of this section is made to satisfy an obligation, the obligation is discharged to the same extent discharge would result from payment to the beneficiary of the same amount in money, unless (i) the payment under subsection (a) of this section was made by a means prohibited by the contract of the beneficiary with respect to the obligation, (ii) the beneficiary, within a reasonable time after receiving notice of receipt of the order by the beneficiary's bank, notified the originator of the beneficiary's refusal of the payment, (iii) funds with respect to the order were not withdrawn by the beneficiary or applied to a debt of the beneficiary, and (iv) the beneficiary would suffer a loss that could reasonably have been avoided if payment had been made by a means complying with the

contract. If payment by the originator does not result in discharge under this section, the originator is subrogated to the rights of the beneficiary to receive payment from the beneficiary's bank under section 4-4.5-404 (a).

(c) For the purpose of determining whether discharge of an obligation occurs under subsection (b) of this section, if the beneficiary's bank accepts a payment order in an amount equal to the amount of the originator's payment order less charges of one or more receiving banks in the funds transfer, payment to the beneficiary is deemed to be in the amount of the originator's order unless upon demand by the beneficiary the originator does not pay the beneficiary the amount of the deducted charges.

(d) Rights of the originator or of the beneficiary of a funds transfer under this section may be varied only by agreement of the originator and the beneficiary.

Source: L. 90: Entire article added, p. 359, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. Subsection (a) states the fundamental rule of Article 4A that payment by the originator to the beneficiary is accomplished by providing to the beneficiary the obligation of the beneficiary's bank to pay. Since this obligation arises when the beneficiary's bank accepts a payment order, the originator pays the beneficiary at the time of acceptance and in the amount of the payment order accepted.

2. In a large percentage of funds transfers, the transfer is made to pay an obligation of the originator. Subsection (a) states that the beneficiary is paid by the originator when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. When that happens the effect under subsection (b) is to substitute the obligation of the beneficiary's bank for the obligation of the originator. The effect is similar to that under Article 3 if a cashier's check payable to the beneficiary had been taken by the beneficiary. Normally, payment by funds transfer is sought by the beneficiary because it puts money into the hands of the beneficiary more quickly. As a practical matter the beneficiary and the originator will nearly always agree to the funds transfer in advance. Under subsection (b) acceptance by the beneficiary's bank will result in discharge of the obligation for which payment was made unless the beneficiary had made a contract with respect to the obligation which did not permit payment by the means used. Thus, if there is no contract of the beneficiary with respect to the means of payment of the obligation, acceptance by the beneficiary's bank of a payment order to the account of the beneficiary can result in discharge.

3. Suppose Beneficiary's contract stated that payment of an obligation owed by Originator was to be made by a cashier's check of Bank A. Instead, Originator paid by a funds transfer to Beneficiary's account in Bank B. Bank B accepted a payment order for the benefit of Beneficiary by immediately notifying Beneficiary that the funds were available for withdrawal. Before Beneficiary had a reasonable opportunity to withdraw the funds Bank B suspended payments. Under the unless clause of subsection (b) Beneficiary is not required to accept the payment as discharging the obligation owed by Originator to Beneficiary if Beneficiary's contract means that Beneficiary was not required to accept payment by wire transfer. Beneficiary could refuse the funds transfer as payment of the obligation and could resort to rights under the underlying contract to enforce the obligation. The rationale is that Originator cannot impose the risk of Bank B's insolvency on Beneficiary if Beneficiary had specified another means of payment that did not entail that risk. If Beneficiary is required to accept Originator's payment, Beneficiary would suffer a loss that would not have occurred if payment had been made by a cashier's check on Bank A, and Bank A has not suspended payments. In this case Originator will have to pay twice. It is obliged to pay the amount of its payment order to the bank that accepted it and has to pay the obligation it owes to Beneficiary which has not been discharged. Under the last sentence of subsection (b) Originator is subrogated to Beneficiary's right to receive payment from Bank B under Section 4A-404(a).

4. Suppose Beneficiary's contract called for payment by a Fedwire transfer to Bank B, but the payment order accepted by Bank B was not a Fedwire transfer. Before the funds were withdrawn by Beneficiary, Bank B suspended payments. The sender of the payment order to Bank B paid the amount of the order to Bank B. In this case the payment by Originator did not comply with Beneficiary's contract, but the noncompliance did not result in a loss to Beneficiary as required by subsection (b) (iv). A Fedwire transfer avoids the risk of insolvency of the sender of the payment order to Bank B, but it does not affect the risk that Bank 8 will suspend payments before withdrawal of the funds by Beneficiary. Thus, the unless clause of subsection (b) is not applicable and the obligation owed to Beneficiary is discharged.

5. Charges of receiving banks in a funds transfer normally are nominal in relationship to the amount being paid by the originator to the beneficiary. Wire transfers are normally agreed to in advance and the parties may agree concerning how these charges are to be divided between the parties. Subsection (c) states a rule that applies in the absence of agreement. In some funds transfers charges of banks that execute payment orders are collected by deducting the charges from the amount of the payment order issued by the bank, i.e. the bank issues a payment order that is slightly less than the amount of the payment order that is being executed. The process is described in Comment 3 to Section 4A-302. The result in such a case is that the payment order accepted by the beneficiary's bank will be slightly less than the amount of the originator's order. Subsection (c) recognizes the principle that a beneficiary is entitled to full payment of a debt paid by wire transfer as a condition to discharge. On the other hand, Subsection (c) prevents a beneficiary from denying the originator the benefit of the payment by asserting that discharge did not occur because deduction of bank charges resulted in less than full payment. The typical case is one in which the payment is made to exercise a valuable right such as an option which is unfavorable to the beneficiary. Subsection (c) allows discharge notwithstanding the deduction unless the originator fails to reimburse the beneficiary for the deducted charges after demand by the beneficiary.

PART 5

MISCELLANEOUS PROVISIONS

4-4.5-501. Variation by agreement and effect of funds-transfer system rule. (a) Except as otherwise provided in this article, the rights and obligations of a party to a funds transfer may be varied by agreement of the affected party.

(b) "Funds-transfer system rule" means a rule of an association of banks (i) governing transmission of payment orders by means of a funds-transfer system of the association or rights and obligations with respect to those orders, or (ii) to the extent the rule governs rights and obligations between banks that are parties to a funds transfer in which a federal reserve bank, acting as an intermediary bank, sends a payment order to the beneficiary's bank. Except as otherwise provided in this article, a funds-transfer system rule governing rights and obligations between participating banks using the system may be effective even if the rule conflicts with this article and indirectly affects another party to the funds transfer who does not consent to the rule. A funds-transfer system rule may also govern rights and obligations of parties other than participating banks using the system to the extent stated in sections 4-4.5-404(c), 4-4.5-405(d), and 4-4.5-507(c).

Source: L. 90: Entire article added, p. 360, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. This section is designed to give some flexibility to Article 4A. Funds transfer system rules govern rights and obligations between banks that use the system. They may cover a wide variety of matters such as form and content of payment orders, security procedures, cancellation rights and procedures, indemnity rights, compensation rules for delays in completion of a funds transfer, time and method of settlement, credit restrictions with respect to senders of payment orders and risk allocation with respect to suspension of payments by a participating bank. Funds transfer system rules can be very effective in supplementing the provisions of Article 4A and in filling gaps that may be present in Article 4A. To the extent they do not conflict with Article 4A there is no problem with respect to their effectiveness. In that case they merely supplement Article 4A. Section 4A-5O1 goes further. It states that unless the contrary is stated, funds transfer system rules can override provisions of Article 4A. Thus, rights and obligations of a sender bank and a receiving bank with respect to each other can be different from that stated in Article 4A to the extent a funds transfer system rule applies. Since funds transfer system rules are defined as those governing the relationship between participating banks, a rule can have a direct effect only on participating banks. But a rule that affects the conduct of a participating bank may indirectly affect the rights of nonparticipants such as the originator or beneficiary of a funds transfer, and such a rule can be effective even though it may affect nonparticipants without their consent. For example, a rule night prevent execution of a payment order or might allow cancellation of a payment order with the result that a funds transfer is not completed or is delayed. But a rule purporting to define rights and obligations of nonparticipants

in the system would not be effective to alter Article 4A rights because the rule is not within the definition of funds transfer system rule. Rights and obligations arising under Article 4A may also be varied by agreement of the affected parties, except to the extent Article 4A otherwise provides. Rights and obligations arising under Article 4A can also be changed by Federal Reserve regulations and operating circulars of Federal Reserve Banks. Section 4A-107.

2. Subsection (b)(ii) refers to ACH transfers. Whether an ACH transfer is made through an automated clearing house of a Federal Reserve Bank or through an automated clearing house of another association of banks, the rights and obligations of the originator's bank and the beneficiary's bank are governed by uniform rules adopted by various associations of banks in various parts of the nation. With respect to transfers in which a Federal Reserve Bank acts as intermediary bank these rules may be incorporated, in whole or in part, in operating circulars of the Federal Reserve Bank. Even if not so incorporated these rules can still be binding on the association banks. If a transfer is made through a Federal Reserve Bank, the rules are effective under subsection (b)(ii). If the transfer is not made through a Federal Reserve Bank, the association rules are effective under subsection (b)(i).

4-4.5-502. Creditor process served on receiving bank; setoff by beneficiary's bank. (a) As used in this section, "creditor process" means levy, attachment, garnishment, notice of lien, sequestration, or similar process issued by or on behalf of a creditor or other claimant with respect to an account.

(b) This subsection (b) applies to creditor process with respect to an authorized account of the sender of a payment order if the creditor process is served on the receiving bank. For the purpose of determining rights with respect to the creditor process, if the receiving bank accepts the payment order the balance in the authorized account is deemed to be reduced by the amount of the payment order to the extent the bank did not otherwise receive payment of the order, unless the creditor process is served at a time and in a manner affording the bank a reasonable opportunity to act on it before the bank accepts the payment order.

(c) If a beneficiary's bank has received a payment order for payment to the beneficiary's account in the bank, the following rules apply:

(1) The bank may credit the beneficiary's account. The amount credited may be set off against an obligation owed by the beneficiary to the bank or may be applied to satisfy creditor process served on the bank with respect to the account.

(2) The bank may credit the beneficiary's account and allow withdrawal of the amount credited unless creditor process with respect to the account is served at a time and in a manner affording the bank a reasonable opportunity to act to prevent withdrawal.

(3) If creditor process with respect to the beneficiary's account has been served and the bank has had a reasonable opportunity to act on it, the bank may not reject the payment order except for a reason unrelated to the service of process.

(d) Creditor process with respect to a payment by the originator to the beneficiary pursuant to a funds transfer may be served only on the beneficiary's bank with respect to the debt owed by that bank to the beneficiary. Any other bank served with the creditor process is not obliged to act with respect to the process.

Source: L. 90: Entire article added, p. 360, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. When a receiving bank accepts a payment order, the bank normally receives payment from the sender by debiting an authorized account of the sender. In accepting the sender's order the bank may be relying on a credit balance in the account. If creditor process is served on the bank with respect to the account before the bank accepts the order but the bank employee responsible for the acceptance was not aware of the creditor process at the time the acceptance occurred, it is unjust to the bank to allow the creditor process to take the credit balance on which the bank may have relied. Subsection (b) allows the bank to obtain payment from the sender's account in this case. Under that provision, the balance in the sender's account to which the creditor process applies is deemed to be reduced by the amount of the payment order unless there was sufficient time for notice of the service of creditor process to be received by personnel of the bank responsible for the acceptance.

2. Subsection (c) deals with payment orders issued to the beneficiary's bank. The bank may credit the beneficiary's account when the order is received, but under Section 4A-404(a) the bank incurs no obligation to pay the beneficiary until the order is accepted pursuant to Section 4A-209(b). Thus, before acceptance, the credit to the beneficiary's account is provisional. But under Section 4A-209(b) acceptance occurs if the beneficiary's bank pays the beneficiary pursuant to Section 4A-405(a). Under that provision, payment occurs if the credit to the beneficiary's account is applied to a debt of the beneficiary. Subsection (c)(1) allows the bank to credit the beneficiary's account with respect to a payment order and to accept the order by setting off the credit against an obligation owed to the bank or applying the credit to creditor process with respect to the account.

Suppose a beneficiary's bank receives a payment order for the benefit of a customer. Before the bank accepts the order, the bank learns that creditor process has been served on the bank with respect to the customer's account. Normally there is no reason for a beneficiary's bank to reject a payment order, but if the beneficiary's account is garnished, the bank may be faced with a difficult choice. If it rejects the order, the garnishing creditor's potential recovery of funds of the beneficiary is frustrated. It may be faced with a claim by the creditor that the rejection was a wrong to the creditor. If the bank accepts the order, the effect is to allow the creditor to seize funds of its customer, the beneficiary. Subsection (c)(3) gives the bank no choice in this case. It provides that it may not favor its customer over the creditor by rejecting the order. The beneficiary's bank may rightfully reject only if there is an independent basis for rejection.

3. Subsection (c)(2) is similar to subsection (b). Normally the beneficiary's bank will release funds to the beneficiary shortly after acceptance or it will accept by releasing funds. Since the bank is bound by a garnishment order served before funds are released to the beneficiary, the bank might suffer a loss if funds were released without knowledge that a garnishment order had been served. Subsection (c)(2) protects the bank if it did not have adequate notice of the garnishment when the funds were released.

4. A creditor may want to reach funds involved in a funds transfer. The creditor may try to do so by serving process on the originator's bank, an intermediary bank or the beneficiary's bank. The purpose of subsection (d) is to guide the creditor and the court as to the proper method of reaching the funds involved in a funds transfer. A creditor of the originator can levy on the account of the originator in the originator's bank before the funds transfer is initiated, but that levy is subject to the limitations stated in subsection (b). The creditor of the originator cannot reach any other funds because no property of the originator is being transferred. A creditor of the beneficiary cannot levy on property of the originator and until the funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary, the beneficiary has no property interest in the funds transfer which the beneficiary's creditor can reach. A creditor of the beneficiary that wants to reach the funds to be received by the beneficiary must serve creditor process on the beneficiary's bank to reach the obligation of the beneficiary's bank to pay the beneficiary which arises upon acceptance by the beneficiary's bank under Section 4A-404(a).

5. "Creditor process" is defined in subsection (a) to cover a variety of devices by which a creditor of the holder of a bank account or a claimant to a bank account can seize the account. Procedure and nomenclature varies widely from state to state. The term used in Section 4A-502 is a generic term.

4-4.5-503. Injunction or restraining order with respect to funds transfer. For proper cause and in compliance with applicable law, a court may restrain (i) a person from issuing a payment order to initiate a funds transfer, (ii) an originator's bank from executing the payment order of the originator, or (iii) the beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing the funds. A court may not otherwise restrain a person from issuing a payment order, paying or receiving payment of a payment order, or otherwise acting with respect to a funds transfer.

Source: L. 90: Entire article added, p. 361, § 1, effective January 1, 1991.

OFFICIAL COMMENT

This section is related to Section 4A-502(d) and to Comment 4 to Section 4A-502. It is designed to prevent interruption of a funds transfer after it has been set in motion. The initiation of a funds transfer can be prevented by enjoining the originator or the originator's bank from issuing a payment order. After the funds transfer is completed by acceptance of a payment order by the beneficiary's bank, that bank can be enjoined from releasing funds to the beneficiary or the beneficiary can be enjoined from withdrawing the funds. No other injunc-

tion is permitted. In particular, intermediary banks are protected, and injunctions against the originator and the originator's bank are limited to issuance of a payment order. Except for the beneficiary's bank, nobody can be enjoined from paying a payment order, and no receiving bank can be enjoined from receiving payment from the sender of the order that it accepted.

4-4.5-504. Order in which items and payment orders may be charged to account; order of withdrawals from account. (a) If a receiving bank has received more than one payment order of the sender or one or more payment orders and other items that are payable from the sender's account, the bank may charge the sender's account with respect to the various orders and items in any sequence.

(b) In determining whether a credit to an account has been withdrawn by the holder of the account or applied to a debt of the holder of the account, credits first made to the account are first withdrawn or applied.

Source: L. 90: Entire article added, p. 361, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. Subsection (a) concerns priority among various obligations that are to be paid from the same account. A customer may have written checks on its account with the receiving bank and may have issued one or more payment orders payable from the same account. If the account balance is not sufficient to cover all of the checks and payment orders, some checks may be dishonored and some payment orders may not be accepted. Although there is no concept of wrongful dishonor of a payment order in Article 4A in the absence of an agreement to honor by the receiving bank, some rights and obligations may depend on the amount in the customer's account. Section 4A-209(b)(3) and Section 4A-210(b). Whether dishonor of a check is wrongful also may depend upon the balance in the customer's account. Under subsection (a), the bank is not required to consider the competing items and payment orders in any particular order. Rather it may charge the customer's account for the various items and orders in any order. Suppose there is $12,000 in the customer's account. If a check for $5,000 is presented for payment and the bank receives a $10,000 payment order from the customer, the bank could dishonor the check and accept the payment order. Dishonor of the check is not wrongful because the account balance was less than the amount of the check after the bank charged the account $10,000 on account of the payment order. Or, the bank could pay the check and not execute the payment order because the amount of the order is not covered by the balance in the account.

2. Subsection (b) follows Section 4-208(b) in using the first-in-first-out rule for determining the order in which credits to an account are withdrawn.

4-4.5-505. Preclusions of objection to debit of customer's account. If a receiving bank has received payment from its customer with respect to a payment order issued in the name of the customer as sender and accepted by the bank, and the customer received notification reasonably identifying the order, the customer is precluded from asserting that the bank is not entitled to retain the payment unless the customer notifies the bank of the customer's objection to the payment within one year after the notification was received by the customer.

Source: L. 90: Entire article added, p. 361, § 1, effective January 1, 1991.

OFFICIAL COMMENT

This section is in the nature of a statute of repose for objecting to debits made to the customer's account. A receiving bank that executes payment orders of a customer may have received payment from the customer by debiting the customer's account with respect to a payment order that the customer was not required to pay. For example, the payment order may not have been authorized or verified pursuant to Section 4A-202 or the funds transfer may not have been completed. In either case the receiving bank is obliged to refund the payment to the customer and this obligation to refund payment cannot be varied by agreement. Section 4A-204 and Section 4A-402. Refund may also be required if the receiving bank is not entitled to

payment from the customer because the bank erroneously executed a payment order. Section 4A-303. A similar analysis applies to that case. Section 4A-402(d) and (f) require refund and the obligation to refund may not be varied by agreement. Under 4A-505, however, the obligation to refund may not be asserted by the customer if the customer has not objected to the debiting of the account within one year after the customer received notification of the debit.

4-4.5-506. Rate of interest. (a) If, under this article, a receiving bank is obliged to pay interest with respect to a payment order issued to the bank, the amount payable may be determined (i) by agreement of the sender and receiving bank, or (ii) by a funds-transfer system rule if the payment order is transmitted through a funds-transfer system.

(b) If the amount of interest is not determined by an agreement or rule as stated in subsection (a) of this section, the amount is calculated by multiplying the applicable federal funds rate by the amount on which interest is payable, and then multiplying the product by the number of days for which interest is payable. The applicable federal funds rate is the average of the federal funds rates published by the federal reserve bank of New York for each of the days for which interest is payable divided by three hundred sixty. The federal funds rate for any day on which a published rate is not available is the same as the published rate for the next preceding day for which there is a published rate. If a receiving bank that accepted a payment order is required to refund payment to the sender of the order because the funds transfer was not completed, but the failure to complete was not due to any fault by the bank, the interest payable is reduced by a percentage equal to the reserve requirement on deposits of the receiving bank.

Source: L. 90: Entire article added, p. 361, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. A receiving bank is required to pay interest on the amount of a payment order received by the bank in a number of situations. Sometimes the interest is payable to the sender and in other cases it is payable to either the originator or the beneficiary of the funds transfer. The relevant provisions are Section 4A-204(a), Section 4A-209(b) (3), Section 4A-210(b), Section 4A-305(a), Section 4A-402(d) and Section 4A-404(b). The rate of interest may be governed by a funds transfer system rule or by agreement as stated in subsection (a). If subsection (a) doesn't apply, the rate is determined under subsection (b). Subsection (b) is illustrated by the following example. A bank is obliged to pay interest on $1,000,000 for three days, July 3, July 4, and July 5. The published Fed Funds rate is .082 for July 3 and .081 for July 5. There is no published rate for July 4 because that day is not a banking day. The rate for July 3 applies to July 4. The applicable Fed Funds rate is .08167 (the average of .082, .082, and .081) divided by 360 which equals .0002268. The amount of interest payable is $1,000,000 X .0002268 X 3 = $680.40.

2. In some cases, interest is payable in spite of the fact that there is no fault by the receiving bank. The last sentence of subsection (b) applies to those cases. For example, a funds transfer might not be completed because the beneficiary's bank rejected the payment order issued to it by the originator's bank or an intermediary bank. Section 4A-402(c) provides that the originator is not obliged to pay its payment order and Section 4A-402(d) provides that the originator's bank must refund any payment received plus interest. The requirement to pay interest in this case is not based on fault by the originator's bank. Rather, it is based on restitution. Since the originator's bank had the use of the originator's money, it is required to pay the originator for the value of that use. The value of that use is not determined by multiplying the interest rate by the refundable amount because the originator's bank is required to deposit with the Federal Reserve a percentage of the bank's deposits as a reserve requirement. Since that deposit does not bear interest, the bank had use of the refundable amount reduced by a percentage equal to the reserve requirement. If the reserve requirement is 12%, the amount of interest payable by the bank under the formula stated in subsection (b) is reduced by 12%.

4-4.5-507. Choice of law. (a) The following rules apply unless the affected parties otherwise agree or subsection (c) of this section applies:

(1) The rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located.

(2) The rights and obligations between the beneficiary's bank and the beneficiary are governed by the law of the jurisdiction in which the beneficiary's bank is located.

(3) The issue of when payment is made pursuant to a funds transfer by the originator to the beneficiary is governed by the law of the jurisdiction in which the beneficiary's bank is located.

(b) If the parties described in each paragraph of subsection (a) of this section have made an agreement selecting the law of a particular jurisdiction to govern rights and obligations between each other, the law of that jurisdiction governs those rights and obligations, whether or not the payment order or the funds transfer bears a reasonable relation to that jurisdiction.

(c) A funds-transfer system rule may select the law of a particular jurisdiction to govern (i) rights and obligations between participating banks with respect to payment orders transmitted or processed through the system, or (ii) the rights and obligations of some or all parties to a funds transfer any part of which is carried out by means of the system. A choice of law made pursuant to clause (i) is binding on participating banks. A choice of law made pursuant to clause (ii) is binding on the originator, other sender, or a receiving bank having notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system when the originator, other sender, or receiving bank issued or accepted a payment order. The beneficiary of a funds transfer is bound by the choice of law if, when the funds transfer is initiated, the beneficiary has notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system. The law of a jurisdiction selected pursuant to this subsection (c) may govern, whether or not that law bears a reasonable relation to the matter in issue.

(d) In the event of inconsistency between an agreement under subsection (b) of this section and a choice-of-law rule under subsection (c) of this section, the agreement under subsection (b) of this section prevails.

(e) If a funds transfer is made by use of more than one funds-transfer system and there is inconsistency between choice-of-law rules of the systems, the matter in issue is governed by the law of the selected jurisdiction that has the most significant relationship to the matter in issue.

Source: L. 90: Entire article added, p. 362, § 1, effective January 1, 1991.

OFFICIAL COMMENT

1. Funds transfers are typically interstate or international in character. If part of a funds transfer is governed by Article 4A and another part is governed by other law, the rights and obligations of parties to the funds transfer may be unclear because there is no clear consensus in various jurisdictions concerning the juridical nature of the transaction. Unless all of a funds transfer is governed by a single law it may be very difficult to predict the result if something goes wrong in the transfer. Section 4A-507 deals with this problem. Subsection (b) allows parties to a funds transfer to make a choice-of-law agreement. Subsection (c) allows a funds transfer system to select the law of a particular jurisdiction to govern funds transfers carried out by means of the system. Subsection (a) states residual rules if no choice of law has occurred under subsection (b) or subsection (c).

2. Subsection (a) deals with three sets of relationships. Rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located. If the receiving bank is the beneficiary's bank the rights and obligations of the beneficiary are also governed by the law of the jurisdiction in which the receiving bank is located. Suppose Originator, located in Canada, sends a payment order to Originator's Bank located in a state in which Article 4A has been enacted. The order is for payment to an account of Beneficiary in a bank in England. Under subsection (a) (1), the rights and obligations of Originator and Originator's Bank toward each other are governed by Article 4A if an action is brought in a court in the Article 4A state. If an action is brought in a Canadian court, the conflict of laws issue will be determined by Canadian law which might or might not apply the law of the state in which Originator's Bank is located. If that law is applied, the execution of Originator's order will be governed by Article 4A, but with respect to the payment order of Originator's Bank to the English bank, Article 4A may or may not be applied with respect to the rights and obligations between the two banks. The result may depend upon whether action is brought in a court in the

state in which Originator's Bank is located or in an English court. Article 4A is binding only on a court in a state that enacts it. It can have extraterritorial effect only to the extent courts of another jurisdiction are willing to apply it. Subsection (c) also bears on the issues discussed in this Comment.

Under Section 4A-406 payment by the originator to the beneficiary of the funds transfer occurs when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. A jurisdiction in which Article 4A is not in effect may follow a different rule or it may not have a clear rule. Under Section 4A-507(a)(3) the issue is governed by the law of the jurisdiction in which the beneficiary's bank is located. Since the payment to the beneficiary is made through the beneficiary's bank it is reasonable that the issue of when payment occurs be governed by the law of the jurisdiction in which the bank is located. Since it is difficult in many cases to determine where a beneficiary is located, the location of the beneficiary's bank provides a more certain rule.

3. Subsection (b) deals with choice-of-law agreements and it gives maximum freedom of choice. Since the law of funds transfers is not highly developed in the case law there may be a strong incentive to choose the law of a jurisdiction in which Article 4A is in effect because it provides a greater degree of certainty with respect to the rights of various parties. With respect to commercial transactions, it is often said that "uniformity and predictability based upon commercial convenience are the prime considerations in making the choice of governing law . . ." R. Leflar, American Conflicts Law, § 185 (1977). Subsection (b) is derived in part from recently enacted choice-of-law rules in the States of New York and California. N.Y. Gen. Obligations Law 5-1401 (McKinney's 1989 Supp.) and California Civil Code § 1646.5. This broad endorsement of freedom of contract is an enhancement of the approach taken by Restatement (Second) of Conflict of Laws § 187(b) (1971). The Restatement recognizes the basic right of freedom of contract, but the freedom granted the parties may be more limited than the freedom granted here. Under the formulation of the Restatement, if there is no substantial relationship to the jurisdiction whose law is selected and there is no "other" reasonable basis for the parties' choice, then the selection of the parties need not be honored by a court. Further, if the choice is violative of a fundamental policy of a state which has a materially greater interest than the chosen state, the selection could be disregarded by a court. Those limitations are not found in subsection (b).

4. Subsection (c) may be the most important provision in regard to creating uniformity of law in funds transfers. Most rights stated in Article 4A regard parties who are in privity of contract such as originator and beneficiary, sender and receiving banks and beneficiary's bank and beneficiary. Since they are in privity they can make a choice of law by agreement. But that is not always the case. For example. an intermediary bank that improperly executes a payment order is not in privity with either the originator or the beneficiary. The ability of a funds transfer system to make a choice of law by rule is a convenient way of dispensing with individual agreements and to cover cases in which agreements are not feasible. It is probable that funds transfer systems will adopt a governing law to increase the certainty of commercial transactions that are effected over such systems. A system rule might adopt the law of an Article 4A state to govern transfers on the system in order to provide a consistent, unitary, law governing all transfers made on the system. To the extent such system rules develop, individual choice-of-law agreements become unnecessary.

Subsection (c) has broad application. A system choice of law applies not only to rights and obligations between banks that use the system, but may also apply to other parties to the funds transfer so long as some part of the transfer was carried out over the system. The originator and any other sender or receiving bank in the funds transfer is bound if at the time it issues or accepts a payment order it had notice that the funds transfer involved use of the system and that the system chose the law of a particular jurisdiction. Under Section 4A-107, the Federal Reserve by regulation could make a similar choice of law to govern funds transfers carried out by use of Federal Reserve Banks. Subsection (d) is a limitation on subsection (c). If parties have made a choice-of-law agreement that conflicts with a choice of law made under subsection (c), the agreement prevails.

5. Subsection (e) addresses the case in which a funds transfer involves more than one funds transfer system and the systems adopt conflicting choice-of-law rules. The rule that has the most significant relationship to the matter at issue prevails. For example, each system should be able to make a choice of law governing payment orders transmitted over that system without regard to a choice of law made by another system.

ARTICLE 5

Letters of Credit

Editor's note: This article was numbered as article 5 of chapter 155, C.R.S. 1963. The provisions of this article were repealed and reenacted in 1996, resulting in the addition, relocation, and

elimination of sections as well as subject matter. For amendments to this article prior to 1996, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated.

Law reviews: For article, "Letters of Credit in Limited Partnership Financing — A Legal Time Bomb?", see 13 Colo. Law. 1989 (1984); for article, "A Primer to Drafting and Reviewing Letters of Credit — Parts I and II", see 15 Colo. Law. 1775 and 1941 (1986); for article, "An Updated Primer on Letters of Credit", see 28 Colo. Law. 5 (April 1999).

PREFATORY NOTE

Reason for Revision

When the original Article 5 was drafted 40 years ago, it was written for paper transactions and before many innovations in letters of credit. Now electronic and other media are used extensively. Since the 50's, standby letters of credit have developed and now nearly $500 billion standby letters of credit are issued annually worldwide, of which $250 billion are issued in the United States. The use of deferred payment letters of credit has also greatly increased. The customs and practices for letters of credit have evolved and are reflected in the Uniform Customs and Practice (UCP), usually incorporated into letters of credit, particularly international letters of credit, which have seen four revisions since the 1950's; the current version became effective in 1994 (UCP 500). Lastly, in a number of areas, court decisions have resulted in conflicting rules.

Prior to the appointment of a drafting committee, the ABA UCC Committee appointed a Task Force composed of knowledgeable practitioners and academics. The ABA Task Force studied the case law, evolving technologies and the changes in customs and practices. The Task Force identified a large number of issues which they discussed at some length, and made recommendations for revisions to Article 5. The Task Force stated in a foreword:

"As a result of these increases and changes in usage, practice, players, and pressure, it comes as no surprise that there has been a sizable increase in litigation. Indeed, the approximately 62 cases reported in the United States in 1987 constituted double the cumulative reported cases up to 1965 ... .

Moreover, almost forty years of hard use have revealed weaknesses, gaps and errors in the original statute which compromise its relevance. U.C.C. Article 5 was one of the few areas of the Uniform Commercial Code which did not benefit from prior codification and it should come as no surprise that it may require some revision ... .

Measured in terms of these areas which are vital to any system of commercial law, the current combination of statute and case law is found wanting in major respects both as to predictability and certainty. What is at issue here are not matters of sophistry but important issues of substance which have not been resolved by the current case law/code method and which admit of little likelihood of such resolution." (45 Bus. Lawyer 1521, at 1532, 1535-6)[1]

The Drafting Committee began its deliberations with the Task Force Report in hand. The final work of the Drafting Committee varies from many of the suggestions of the Task Force.

[1] The Task Force members were: Professor James E. Byrne (George Mason University School of Law) Chair; Professor Boris Kozolchyk (University of Arizona College of Law); Michael Evan Avidon (Moses & Singer); James G. Barnes (Baker & McKenzie); Arthur G. Lloyd (Citibank N.A.); Janis S. Penton (Rosen, Wachtell & Gilbert); Richard F. Purcell (Connell, Rice & Sugar Co.); Alan L. Bloodgood (Morgan Guaranty Trust Co.); Charles del Busto (Manufacturers Hanover Trust Co.); Vincent Maulella (Manufacturers Hanover Trust Co.).

Need for Uniformity

Letters of Credit are a major instrument in international trade, as well as domestic transactions. To facilitate its usefulness and competitiveness, it is essential that U.S. law be in harmony with international rules and practices, as well as flexible enough to accommodate changes in technology and practices that have, and are, evolving. Not only should the rules be consistent within the United States, but they need to be substantively and procedurally consistent with international practices.

Thus, the goals of the drafting effort were:

- conforming the Article 5 rules to current customs and practices;
- accommodating new forms of Letters of Credit, changes in customs and practices, and evolving technology, particularly the use of electronic media;
- maintaining Letters of Credit as an inexpensive and efficient instrument facilitating trade; and
- resolving conflicts among reported decisions.

Process of Achieving Uniformity

The essence of uniform law revision is to obtain a sufficient consensus and balance among the interests of the various participants so that universal and uniform enactment by the various States may be achieved.

In part this is accomplished by extensive consultation on and broad circulation of the drafts from 1990, when the project began, until approval of the final draft by the American law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL).

Hundreds of groups were invited to participate in the drafting process. Twenty Advisors were appointed, representing a cross-section of interested parties. In addition 20 Observers regularly attended drafting meetings and over 100 were on the mailing list to receive all drafts of the revision.

The Drafting Committee meetings were open and all those who attended were afforded full opportunity to express their views and participate in the dialogue. The Advisors and Observers were a balanced group with ten representatives of users (Beneficiaries and Applicants); five representatives of governmental agencies; five representatives of the U.S. Council on International Banking (USCIB); seven from major banks in letter of credit transactions; eight from regional banks; and seven law professors who teach and write on Letters of Credit.

Nine Drafting Committee meetings were held that began Friday morning and ended Sunday noon. In addition, the draft was twice debated in full by NCCUSL, once by the ALI Council, once considered by the ALI Consultative Group and once by an ad hoc Committee of the Council; and reviewed and discussed by the ABA Subcommittee on Letters of Credit semi-annually and by several state and city bar association committees.

The drafts were regularly reviewed and discussed in The Business Lawyer, Letter of Credit Update, and in other publications.

The consensus, balance and quality achieved in this lengthy deliberative process is a product of not only its Reporter and the Drafting Committee, but also the faithful and energetic participation of the following Advisors and active participants:

Advisors

Professor Gerald T. McLaughlin, Loyola Law School, ABA, Section of Business Law
James G. Barnes, Baker & McKenzie/U.S. Council on International Banking, Inc.
Harold S. Burman, U.S. Department of State
James E. Byrne, George Mason University, Institute of International Banking Law and Practice Inc.
Professor John Dolan, original ABA Advisor
Henry N. Dyhouse, U.S. Central Credit Union
David P. Goch, Treasury Management Association
Thomas J. Greco, American Bankers Association
Henry Harfield, Shearman & Sterling
Oliver I. Ireland, Board of Governors of Federal Reserve Board
James W. Kopp, Shell Oil Company/Treasury Management Association
Professor Boris Kozolchyk, University of Arizona/National Law Center for Inter-American Free Trade, U.S. Council on International Banking, Inc.
Vincent M. Maulella, Manufacturers Hanover Trust Co./U.S. Council on International Banking, Inc.
Robert M. Rosenblith, National Westminster Bank
Bradley K. Sabel, Federal Reserve Bank of New York
Joseph H. Sommer, Federal Reserve Bank of New York
Jamileh Soufan, American General Corporation/Treasury Management Association
Dan Taylor, U.S. Council on International Banking, Inc.
William H. Thornton, Security Pacific National Bank/California Bankers Association
Paul S. Turner, Occidental Petroleum Corporation/Treasury Management Association
Stanley M. Walker, Exxon Company U.S.A./Treasury Management Association

Active Participants

Michael E. Avidon, Moses & Singer/N.Y. State Bar Association, Banking Law Committee, Subcommittee on Letters of Credit
Walter B. Baker, ABN AMRO Bank, N.V.
Thomas C. Baxter, Jr., Federal Reserve Bank of New York

Professor Amelia H. Boss, Pennsylvania Bar Association, Section of Corporation, Banking & Business Law, Commercial Law Committee
Maria A. Chanco, Bank of America, N.T. & S.A.
Frank P. Curran, Treasury Management Association
Carol R. Dennis, Office of Federal Procurement Policy, OFMB
Albert J. Givray, Oklahoma Bar Association, Section of Banking & Commercial Law
Sidney S. Goldstein, New York State Bar Association
Professor Egon Guttman, The American University
George A. Hisert, State Bar of California, Section of Business Law, Committee on UCC, Subcommittee on Letters of Credit
Larry J. Jones, Mobil Oil Credit Corporation
Carter H. Klein, Jenner & Block
Arthur G. Lloyd, ABA, Section of Business Law, Committee on UCC, Subcommittee on Letters of Credit, Working Group on UCC Article 5 Revision
Rebecca S. McCulloch, ABN AMRO Bank, N.V.
Dennis L. Noah, First National Bank of Maryland/U.S. Council on International Banking, Inc.
James Purvis, The Bank of California
James E. Roselle, First National Bank of Chicago
R. David Whitaker, ABA, Section of Business Law, Committee on UCC, Subcommittee on ECP, Working Group on EDC
Brooke Wunnicke, ABA, Section of Business Law, Committee on UCC, Subcommittee on Letters of Credit

Balance of Benefits

Uniform laws can be enacted only if there is a consensus that the benefits achieved advance the public interest in a manner that can be embraced by all users of the law. It appears that as drafted, Revised Article 5 will enjoy substantial support by the participating interests in letter of credit transactions.

Benefits of Revised Article 5 in General

Independence Principle. Revised Article 5 clearly and forcefully states the independence of the letter of credit obligations from the underlying transactions that was unexpressed in, but was a fundamental predicate for, the original Article 5 (Sections 5-103(d) and 5-108(f)). Certainty of payment, independent of other claims, setoffs or other causes of action, is a core element of the commercial utility of letters of credit.

Clarifications. The revision authorizes the use of electronic technology (Sections 5-102(a)(14) and 5-104); expressly permits deferred payment letters of credit (Section 5-102(a)(8)) and two party letters of credit (Section 5-102(a)(10)); provides rules for unstated expiry dates (Section 5-106(c)), perpetual letters of credit (Section 5-106(d)), and non-documentary conditions (Section 5-108(g)); clarifies and establishes rules for successors by operation of law (Sections 5-102(a)(15) and 5-113); conforms to existing practice for assignment of proceeds (Section 5-114); and clarifies the rules where decisions have been in conflict (Section 5-106, Comment 1; Section 5-108, Comments 1, 3, 4, 7, and 9; Section 5-109, Comments 1 and 3; Section 5-113, Comment 1; and Section 5-117, Comment 1).

Harmonizes with International Practice

The UCP is used in most international letters of credit and in many domestic letters of credit. These international practices are well known and employed by the major issuers and users of letters of credit. Revisions have been made to Article 5 to coordinate the Article 5 rules with current international practice (e.g., deferred payment obligations, reasonable time to examine documents, preclusion, non-documentary conditions, return of documents, and irrevocable unless stated to be revocable).

Benefits of Revised Article 5 to Issuers

Consequential Damages. Section 5-111 precludes consequential and punitive damages. It, however, provides strong incentives for Issuers to honor, including provisions for attorneys fees and expenses of litigation, interest, and specific performance. If consequential and punitive damages were allowed, the cost of letters of credit could rise substantially.

Statute of Limitation. Section 5-115 establishes a one year statute of limitation from the expiration date or from accrual of the cause of action, whichever occurs later. Because it is usually obvious to all when there has been a breach, a short limitation period is fair to potential plaintiffs.

Choice of Law. Section 5-116 permits the issuer (or nominated party or adviser) to choose the law of the jurisdiction that will govern even if that law bears no relation to the transaction. Absent agreement, Section 5-116 states choice of law rules.

Assignment of Proceeds. Section 5-114 conforms more fully to existing practice and provides an orderly procedure for recording and accommodating assignments by consent of the issuer (or nominated party).

Subrogation. Section 5-117 clarifies the subrogation rights of an Issuer who has honored a letter of credit. These rights of subrogation also extend to an applicant who reimburses and a nominated party who pays or gives value.

Recognition of UCP. Section 5-116(c) expressly recognizes that if the UCP is incorporated by reference into the letter of credit, the agreement varies the provisions of Article 5 with which it may conflict except for the non-variable provisions of Article 5.

Benefits of Revised Article 5
to Applicants

Warranties. Section 5-110 specifies the warranties made by a beneficiary. It gives the applicant on a letter of credit which has been honored a direct cause of action if a drawing is fraudulent or forged or if a drawing violates any agreement augmented by a letter of credit.

Strict Compliance. Absent agreement to the contrary, the issuer must dishonor a presentation that does not strictly comply under standard practice with the terms and conditions of the letter of credit (Section 5-108).

Subrogation. New Section 5-117 clarifies the parties rights of subrogation if the letter of credit is honored.

Limitations on General Disclaimers and Waivers. Section 5-103(c) limits the effect of general disclaimers and waivers in a letter of credit, or reimbursement or other agreement.

Benefits of Revised Article 5
to Beneficiaries

Irrevocable. A letter of credit is irrevocable unless the letter of credit expressly provides it is revocable (Section 5-106(a)).

Preclusion. Section 5-108(c) now provides that the Issuer is precluded from asserting any discrepancy not stated in its notice timely given, except for fraud, forgery or expiration.

Timely Examination. Section 5-108(b) requires examination and notice of any discrepancies within a reasonable time not to exceed the 7th business day after presentation of the documents.

Transfers by Operation of Law. New Section 5-113 allows a successor to a beneficiary by operation of law to make presentation and receive payment or acceptance.

Damages. The damages provided are expanded and clarified. They include attorneys fees and expenses of litigation and payment of the full amount of the wrongfully dishonored or repudiated demand, with interest, without an obligation of the beneficiary to mitigate damages (Section 5-111).

Revisions for Article 9 and
Transition Provisions

The draft includes suggested revisions to conform Article 9 to the Article 5 changes. Article 9 itself is under revision and the interface with Revised Article 5 will be more fully examined by the Article 9 drafting committee, as well, in light of changes to Article 9. The Article 9 revisions will probably not be completed until 1998-9. Revised Article 8 (1994) also makes changes to Article 9 so care should be taken to coordinate the changes of both Revised Articles 5 and 8 within each State.

The draft also includes transition provisions and some cross reference changes in other Articles of the UCC.

Lastly, there follows a table showing the changes from the original Article 5 made by the revisions to Article 5.

**Table of Disposition of Sections
in Former Article 5**

The reference to a section in revised Article 5 is to the section that refers to the issue addressed by the section in former Article 5. If there is no comparable section in Revised Article 5 to a section in former Article 5, that fact is indicated by the word "Omitted" and a reason is stated.

Former Article 5 Section	**Revised Article 5 Section**
5-101	5-101
5-102(1)	5-103(a)
5-102(2)	Omitted (inherent in 5-103(a) and definitions)
5-103(3) (first sentence omitted)	5-103(b)
5-103(1)(a)	5-102(a)(10)
5-106(a)	
5-102(a)(8)	
5-103(1)(b)	5-102(a)(6) ("Document"), and 5-102(a)(14) ("Record") "Documentary" draft or demand not used
5-103(1)(c)	5-102(a)(9)
5-103(1)(d)	5-102(a)(3)
5-103(1)(e)	5-102(a)(1)
5-103(1)(f)	5-102(a)(4)
5-103(1)(g)	("Applicant" rather than "Customer") 5-102(a)(2)
5-103(2)	Omitted as not applicable
5-103(3)	5-102(b)
5-103(4)	5-102(c)
5-104	5-104 and 5-102(6) and (14)
5-105	5-105
5-106(1)	5-106(a)
5-106(2)	5-106(b)
5-106(3)	5-106(b)
5-106(4)	5-106(b)
5-107(1)	5-107(c)
5-107(2)	5-107(a)
5-107(3)	5-107(c)

5-107(4)	Omitted as inadvisable default rule
5-108	Omitted (as outdated)
5-109(1)	5-108
5-109(2)	5-108
5-109(3)	Omitted (all issuers required to observe standard practices)
5-110(1)	Omitted (covered in definitions and comments)
5-110(2)	Omitted (covered in definitions and comments)
5-111(1)	5-110(a)
5-111(2)	5-110(b)
5-112(1)	5-108(b) and (c)
5-112(2)	5-108(h)
5-112(3)	5-102(a)(12)
5-113	Omitted (covered by other contract law)
5-114(1)	5-108(a)
5-114(2)(a)	5-109(a)(1)
5-114(2)(b)	5-109(a)(2)
5-114(3)	5-108(i)
5-114(4), (5)	Omitted were optional
5-115(1)	5-111
5-115(2)	5-111
5-116(1)	5-112
5-116(2)	5-114
5-116(3)	5-114
5-117	Omitted (covered by other law)

Table of New Provisions

(Provisions which were not included in former Article 5 and subjects not addressed in former Article 5.)

Subject	**Revised Article 5 Section**
"Successor to a beneficiary"	5-102(15)
Non-variable terms	5-103(c)
Independence principle	5-103(d)
Unstated expiry date	5-106(c)
Perpetual letter of credit	5-106(d)
Preclusion of unstated deficiencies	5-108(c)
Standard practice	5-108(e)
Independence of obligation	5-108(f)
Non-documentary conditions	5-108(g)
Standards for issuing injunction	5-109(b)
Transfer by operation of law	5-113
Statute of Limitation	5-115
Choice of law	5-116
Subrogation	5-117

4-5-101. Short title. This article may be cited as "Uniform Commercial Code - Letters of Credit".

Source: L. 96: Entire article R&RE, p. 191, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-101 as it existed prior to 1996.

OFFICIAL COMMENT

The Official Comment to the original Section 5-101 was a remarkably brief inaugural address. Noting that letters of credit had not been the subject of statutory enactment and that the law concerning them had been developed in the cases, the Comment stated that Article 5 was intended "within its limited scope" to set an independent theoretical frame for the further development of letters of credit. That statement addressed accurately conditions as they existed when the statement was made, nearly half a century ago. Since Article 5 was originally drafted, the use of letters of credit has expanded and developed, and the case law concerning these developments is, in some respects, discordant.

Revision of Article 5 therefore has required reappraisal both of the statutory goals and of the extent to which particular statutory provisions further or adversely affect achievement of those goals.

The statutory goal of Article 5 was originally stated to be: (1) to set a substantive theoretical frame that describes the function and legal nature of letters of credit; and (2) to preserve procedural flexibility in order to accommodate further development of the efficient use of letters of credit. A letter of credit is an idiosyncratic form of undertaking that supports performance of an obligation incurred in a separate financial, mercantile, or other transaction or arrangement. The objectives of the original and revised Article 5 are best achieved (1) by defining the peculiar characteristics of a letter of credit that distinguish it and the legal consequences of its use from other forms of assurance such as secondary guarantees, performance bonds, and insurance policies, and from ordinary contracts, fiduciary engagements, and escrow arrangements; and (2) by preserving flexibility through variation by agreement in order to respond to and accommodate developments in custom and usage that are not inconsistent with the essential definitions and substantive mandates of the statute. No statute can, however, prescribe the manner in which such substantive rights and duties are to be enforced or imposed without risking stultification of wholesome developments in the letter of credit mechanism. Letter of credit law should remain responsive to commercial reality

and in particular to the customs and expectations of the international banking and mercantile community. Courts should read the terms of this article in a manner consistent with these customs and expectations.

The subject matter in Article 5, letters of credit, may also be governed by an international convention that is now being drafted by UNCITRAL, the draft Convention on Independent Guarantees and Standby Letters of Credit. The Uniform Customs and Practice is an international body of trade practice that is commonly adopted by international and domestic letters of credit and as such is the "law of the transaction" by agreement of the parties. Article 5 is consistent with and was influenced by the rules in the existing version of the UCP. In addition to the UCP and the international convention, other bodies of law apply to letters of credit. For example, the federal bankruptcy law applies to letters of credit with respect to applicants and beneficiaries that are in bankruptcy; regulations of the Federal Reserve Board and the Comptroller of the Currency lay out requirements for banks that issue letters of credit and describe how letters of credit are to be treated for calculating asset risk and for the purpose of loan limitations. In addition there is an array of anti-boycott and other similar laws that may affect the issuance and performance of letters of credit. All of these laws are beyond the scope of Article 5, but in certain circumstances they will override Article 5.

ANNOTATION

Applied in Dovenmuehle, Inc. v. East Bank, 38 Colo. App. 507, 563 P.2d 24 (1977).

4-5-102. Definitions. (a) In this article:

(1) "Adviser" means a person who, at the request of the issuer, a confirmer, or another adviser, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed, or amended.

(2) "Applicant" means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

(3) "Beneficiary" means a person who under the terms of a letter of credit is entitled to have its complying presentation honored. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit.

(4) "Confirmer" means a nominated person who undertakes, at the request or with the consent of the issuer, to honor a presentation under a letter of credit issued by another.

(5) "Dishonor" of a letter of credit means failure timely to honor or to take an interim action, such as acceptance of a draft, that may be required by the letter of credit.

(6) "Document" means a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right, or opinion (i) which is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in section 4-5-108 (e) and (ii) which is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral.

(7) "Good faith" means honesty in fact in the conduct or transaction concerned.

(8) "Honor" of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, "honor" occurs:

(i) Upon payment;

(ii) If the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment; or

(iii) If the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.

(9) "Issuer" means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes.

(10) "Letter of credit" means a definite undertaking that satisfies the requirements of section 4-5-104 by an issuer to a beneficiary at the request or for the account of an applicant

or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

(11) "Nominated person" means a person whom the issuer (i) designates or authorizes to pay, accept, negotiate, or otherwise give value under a letter of credit and (ii) undertakes by agreement or custom and practice to reimburse.

(12) "Presentation" means delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit.

(13) "Presenter" means a person making a presentation as or on behalf of a beneficiary or nominated person.

(14) "Record" means information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form.

(15) "Successor of a beneficiary" means a person who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the beneficiary has been merged or consolidated, an administrator, executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator, and receiver.

(b) Definitions in other articles applying to this article and the sections in which they appear are:

Accept or acceptance	Section 4-3-409
Value	Sections 4-3-303, 4-4-211

(c) Article 1 of this title contains certain additional general definitions and principles of construction and interpretation applicable throughout this article.

Source: L. 96: Entire article R&RE, p. 191, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-103 as it existed prior to 1996.

OFFICIAL COMMENT

1. Since no one can be a confirmer unless that person is a nominated person as defined in Section 5-102(a)(11), those who agree to "confirm" without the designation or authorization of the issuer are not confirmers under Article 5. Nonetheless, the undertakings to the beneficiary of such persons may be enforceable by the beneficiary as letters of credit issued by the "confirmer" for its own account or as guarantees or contracts outside of Article 5.

2. The definition of "document" contemplates and facilitates the growing recognition of electronic and other nonpaper media as "documents," however, for the time being, data in those media constitute documents only in certain circumstances. For example, a facsimile received by an issuer would be a document only if the letter of credit explicitly permitted it, if the standard practice authorized it and the letter did not prohibit it, or the agreement of the issuer and beneficiary permitted it. The fact that data transmitted in a nonpaper (unwritten) medium can be recorded on paper by a recipient's computer printer, facsimile machine, or the like does not under current practice render the data so transmitted a "document." A facsimile or S.W.I.F.T. message received directly by the issuer is in an electronic medium when it crosses the boundary of the issuer's place of business. One wishing to make a presentation by facsimile (an electronic medium) will have to procure the explicit agreement of the issuer (assuming that the standard practice does not authorize it). Where electronic transmissions are authorized neither by the letter of credit nor by the practice, the beneficiary may transmit the data electronically to its agent who may be able to put it in written form and make a conforming presentation.

3. "Good faith" continues in revised Article 5 to be defined as "honesty in fact." "Observance of reasonable standards of fair dealing" has not been added to the definition. The narrower definition of "honesty in fact" reinforces the "independence principle" in the treatment of "fraud," "strict compliance," "preclusion," and other tests affecting the performance of obligations that are unique to letters of credit. This narrower definition — which does not include "fair dealing" — is appropriate to the decision to honor or dishonor a presentation of documents specified in a letter of credit. The narrower definition is also appropriate for other parts of revised Article 5 where greater certainty of obligations is necessary and is consistent with the goals of speed and low cost. It is important that U.S. letters of credit have continuing vitality and competitiveness in international transactions.

For example, it would be inconsistent with the "independence" principle if any of the following occurred: (i) the beneficiary's failure to adhere to the standard of "fair dealing" in the underlying transaction or otherwise in presenting documents were to provide applicants and

issuers with an "unfairness" defense to dishonor even when the documents complied with the terms of the letter of credit; (ii) the issuer's obligation to honor in "strict compliance in accordance with standard practice" were changed to "reasonable compliance" by use of the "fair dealing" standard, or (iii) the preclusion against the issuer (Section 5-108(d)) were modified under the "fair dealing" standard to enable the issuer later to raise additional deficiencies in the presentation. The rights and obligations arising from presentation, honor, dishonor and reimbursement, are independent and strict, and thus "honesty in fact" is an appropriate standard.

The contract between the applicant and beneficiary is not governed by Article 5, but by applicable contract law, such as Article 2 or the general law of contracts. "Good faith" in that contract is defined by other law, such as Section 2-103(1)(b) or Restatement of Contracts 2d, § 205, which incorporate the principle of "fair dealing" in most cases, or a State's common law or other statutory provisions that may apply to that contract.

The contract between the applicant and the issuer (sometimes called the "reimbursement" agreement) is governed in part by this article (e.g., Sections 5-108(i), 5-111(b), and 5-103(c)) and partly by other law (e.g., the general law of contracts). The definition of good faith in Section 5-102(a)(7) applies only to the extent that the reimbursement contract is governed by provisions in this article; for other purposes good faith is defined by other law.

4. Payment and acceptance are familiar modes of honor. A third mode of honor, incurring an unconditional obligation, has legal effects similar to an acceptance of a time draft but does not technically constitute an acceptance. The practice of making letters of credit available by "deferred payment undertaking" as now provided in UCP 500 has grown up in other countries and spread to the United States. The definition of "honor" will accommodate that practice.

5. The exclusion of consumers from the definition of "issuer" is to keep creditors from using a letter of credit in consumer transactions in which the consumer might be made the issuer and the creditor would be the beneficiary. If that transaction were recognized under Article 5, the effect would be to leave the consumer without defenses against the creditor. That outcome would violate the policy behind the Federal Trade Commission Rule in 16 CFR Part 433. In a consumer transaction, an individual cannot be an issuer where that person would otherwise be either the principal debtor or a guarantor.

6. The label on a document is not conclusive; certain documents labelled "guarantees" in accordance with European (and occasionally, American) practice are letters of credit. On the other hand, even documents that are labelled "letter of credit" may not constitute letters of credit under the definition in Section 5-102(a). When a document labelled a letter of credit requires the issuer to pay not upon the presentation of documents, but upon the determination of an extrinsic fact such as applicant's failure to perform a construction contract, and where that condition appears on its face to be fundamental and would, if ignored, leave no obligation to the issuer under the document labelled letter of credit, the issuer's undertaking is not a letter of credit. It is probably some form of suretyship or other contractual arrangement and may be enforceable as such. See Sections 5-102(a)(10) and 5-103(d). Therefore, undertakings whose fundamental term requires an issuer to look beyond documents and beyond conventional reference to the clock, calendar, and practices concerning the form of various documents are not governed by Article 5. Although Section 5-108(g) recognizes that certain nondocumentary conditions can be included in a letter of credit without denying the undertaking the status of letter of credit, that section does not apply to cases where the nondocumentary condition is fundamental to the issuer's obligation. The rules in Sections 5-102(a)(10), 5-103(d), and 5-108(g) approve the conclusion in Wichita Eagle & Beacon Publishing Co. v. Pacific Nat. Bank, 493 F.2d 1285 (9th Cir. 1974).

The adjective "definite" is taken from the UCP. It approves cases that deny letter of credit status to documents that are unduly vague or incomplete. See, e.g., Transparent Products Corp. v. Paysaver Credit Union, 864 F.2d 60 (7th Cir. 1988). Note, however, that no particular phrase or label is necessary to establish a letter of credit. It is sufficient if the undertaking of the issuer shows that it is intended to be a letter of credit. In most cases the parties' intention will be indicated by a label on the undertaking itself indicating that it is a "letter of credit," but no such language is necessary.

A financial institution may be both the issuer and the applicant or the issuer and the beneficiary. Such letters are sometimes issued by a bank in support of the bank's own lease obligations or on behalf of one of its divisions as an applicant or to one of its divisions as beneficiary, such as an overseas branch. Because wide use of letters of credit in which the issuer and the applicant or the issuer and the beneficiary are the same would endanger the unique status of letters of credit, only financial institutions are authorized to issue them.

In almost all cases the ultimate performance of the issuer under a letter of credit is the payment of money. In rare cases the issuer's obligation is to deliver stock certificates or the like. The definition of letter of credit in Section 5-102(a)(10) contemplates those cases.

7. Under the UCP any bank is a nominated bank where the letter of credit is "freely negotiable." A letter of credit might also nominate by the following: "We hereby engage with the drawer, indorsers, and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same will be duly honored on due presentation" or "available with any bank by negotiation." A restricted negotiation credit might be "available with x bank by negotiation" or the like.

Several legal consequences may attach to the status of nominated person. First, when the issuer nominates a person, it is authorizing that person to pay or give value and is authorizing the beneficiary to make presentation to that person. Unless the letter of credit provides otherwise, the beneficiary need not present the documents to the issuer before the letter of credit expires; it need only present those documents to the nominated person. Secondly, a nominated person that gives value in good faith has a right to payment from the issuer despite fraud. Section 5-109(a)(1).

8. A "record" must be in or capable of being converted to a perceivable form. For example, an electronic message recorded in a computer memory that could be printed from that memory could constitute a record. Similarly, a tape recording of an oral conversation could be a record.

9. Absent a specific agreement to the contrary, documents of a beneficiary delivered to an issuer or nominated person are considered to be presented under the letter of credit to which they refer, and any payment or value given for them is considered to be made under that letter of credit. As the court held in Alaska Textile Co. v. Chase Manhattan Bank, N.A., 982 F.2d 813, 820 (2d Cir. 1992), it takes a "significant showing" to make the presentation of a beneficiary's documents for "collection only" or otherwise outside letter of credit law and practice.

10. Although a successor of a beneficiary is one who succeeds "by operation of law," some of the successions contemplated by Section 5-102(a)(15) will have resulted from voluntary action of the beneficiary such as merger of a corporation. Any merger makes the successor corporation the "successor of a beneficiary" even though the transfer occurs partly by operation of law and partly by the voluntary action of the parties. The definition excludes certain transfers, where no part of the transfer is "by operation of law" — such as the sale of assets by one company to another.

11. "Draft" in Article 5 does not have the same meaning it has in Article 3. For example, a document may be a draft under Article 5 even though it would not be a negotiable instrument, and therefore would not qualify as a draft under Section 3-104(e).

ANNOTATION

Law reviews. For article, "Commercial Law", which discusses recent Tenth Circuit decisions dealing with questions of definition and interpretation, see 63 Den. U.L. Rev. 225 (1986).

Annotator's note. Since § 4-5-102 is similar to § 4-5-103 as it existed prior to the 1996 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Letter of credit not similar to surety contract. An analogy between a surety contract and a letter of credit is not well taken. General Ins. Co. of Am. v. City of Colo. Springs, 638 P.2d 752 (Colo. 1981).

But akin to cashier's check. The letter of credit is closely akin to a cashier's check or other negotiable instrument issued by a bank. Leney v. Plum Grove Bank, 670 F.2d 878 (10th Cir. 1982).

Effect of letter of credit on issuing bank. By issuing a letter of credit, the bank substitutes its credit for that of its customer. Leney v. Plum Grove Bank, 670 F.2d 878 (10th Cir. 1982).

One of the uses of credits is to secure performance of a contract between a bank's customer and a third party. Hyland Hills Metro. Park & Recreational Dist. v. McCoy Enters., Inc., 38 Colo. App. 23, 554 P.2d 708 (1976).

Two separate contracts are involved. The bank issuing the letter of credit is bound by its terms and has no obligation or right to investigate the performance of the other contract to which the credit relates. Hyland Hills Metro. Park & Recreational Dist. v. McCoy Enters., Inc., 38 Colo. App. 23, 554 P.2d 708 (1976).

If printed and written, or typed, provisions of a letter of credit cannot be reconciled, the written, or typed, provisions prevail. Hyland Hills Metro. Park & Recreational Dist. v. McCoy Enters., Inc., 38 Colo. App. 23, 554 P.2d 708 (1976).

Liability of bank where payment not in accordance with credit terms. Payment by a bank, if not in accordance with the terms of the credit, would have rendered the bank liable to the customer. Hyland Hills Metro. Park & Recreational Dist. v. McCoy Enters., Inc., 38 Colo. App. 23, 554 P.2d 708 (1976).

Forum for suing out-of-state issuing bank limited. It is unfair to burden an out-of-state issuing bank with having to defend litigation over a letter of credit in any state in which the bank could reasonably expect the credit to be used. Leney v. Plum Grove Bank, 670 F.2d 878 (10th Cir. 1982).

Bank's obligation held terminated. Where a third party was seeking payment under the letter

of credit because of the bank customer's failure to construct the tennis courts, it was required to present its "signed statement dated January 5, 1974, and presented on that date", setting forth that fact according to the terms of the letter of credit. Upon its failure to do so, the obligation of the bank terminated. Hyland Hills Metro. Park & Recreational Dist. v. McCoy Enters., Inc., 38 Colo. App. 23, 554 P.2d 708 (1976).

"Guaranty letter of credit" issued by a bank requiring a documentary demand, and conspicuously stating that it was a letter of credit, falls squarely within the definition of letter of credit so that a defendant bank cannot escape its obligation to honor a demand on it. East Bank v. Dovenmuehle, Inc., 196 Colo. 422, 589 P.2d 1361 (1978).

Existence of nondocumentary conditions does not invalidate letters of credit. Raiffeisen-Zentralkasse Tirol v. First Nat'l Bank, 671 P.2d 1008 (Colo. App. 1983).

Applied in Colo. Nat'l Bank v. Bd. of County Comm'rs, 634 P.2d 32 (Colo. 1981).

4-5-103. Scope. (a) This article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.

(b) The statement of a rule in this article does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this article.

(c) With the exception of this subsection (c), subsections (a) and (d) of this section, sections 4-5-102 (a) (9) and (10), 4-5-106 (d), and 4-5-114 (d), and except to the extent prohibited in sections 4-1-302 and 4-5-117 (d), the effect of this article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.

(d) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

Source: L. 96: Entire article R&RE, p. 193, § 1, effective July 1. **L. 2006:** (c) amended, p. 498, § 31, effective September 1.

Editor's note: This section is similar to former § 4-5-102 as it existed prior to 1996.

OFFICIAL COMMENT

1. Sections 5-102(a)(10) and 5-103 are the principal limits on the scope of Article 5. Many undertakings in commerce and contract are similar, but not identical to the letter of credit. Principal among those are "secondary," "accessory," or "suretyship" guarantees. Although the word "guarantee" is sometimes used to describe an independent obligation like that of the issuer of a letter of credit (most often in the case of European bank undertakings but occasionally in the case of undertakings of American banks), in the United States the word "guarantee" is more typically used to describe a suretyship transaction in which the "guarantor" is only secondarily liable and has the right to assert the underlying debtor's defenses. This article does not apply to secondary or accessory guarantees and it is important to recognize the distinction between letters of credit and those guarantees. It is often a defense to a secondary or accessory guarantor's liability that the underlying debt has been discharged or that the debtor has other defenses to the underlying liability. In letter of credit law, on the other hand, the independence principle recognized throughout Article 5 states that the issuer's liability is independent of the underlying obligation. That the beneficiary may have breached the underlying contract and thus have given a good defense on that contract to the applicant against the beneficiary is no defense for the issuer's refusal to honor. Only staunch recognition of this principle by the issuers and the courts will give letters of credit the continuing vitality that arises from the certainty and speed of payment under letters of credit. To that end, it is important that the law not carry into letter of credit transactions rules that properly apply only to secondary guarantees or to other forms of engagement.

2. Like all of the provisions of the Uniform Commercial Code, Article 5 is supplemented by Section 1-103 and, through it, by many rules of statutory and common law. Because this article is quite short and has no rules on many issues

that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the article is far from comprehensive; it deals only with "certain" rights of the parties. Particularly with respect to the standards of performance that are set out in Section 5-108, it is appropriate for the parties and the courts to turn to customs and practice such as the Uniform Customs and Practice for Documentary Credits, currently published by the International Chamber of Commerce as I.C.C. Pub. No. 500 (hereafter UCP). Many letters of credit specifically adopt the UCP as applicable to the particular transaction. Where the UCP are adopted but conflict with Article 5 and except where variation is prohibited, the UCP terms are permissible contractual modifications under Sections 1-102(3) and 5-103(c). See Section 5-116(c). Normally Article 5 should not be considered to conflict with practice except when a rule explicitly stated in the UCP or other practice is different from a rule explicitly stated in Article 5.

Except by choosing the law of a jurisdiction that has not adopted the Uniform Commercial Code, it is not possible entirely to escape the Uniform Commercial Code. Since incorporation of the UCP avoids only "conflicting" Article 5 rules, parties who do not wish to be governed by the nonconflicting provisions of Article 5 must normally either adopt the law of a jurisdiction other than a State of the United States or state explicitly the rule that is to govern. When rules of custom and practice are incorporated by reference, they are considered to be explicit terms of the agreement or undertaking.

Neither the obligation of an issuer under Section 5-108 nor that of an adviser under Section 5-107 is an obligation of the kind that is invariable under Section 1-102(3). Section 5-103(c) and Comment 1 to Section 5-108 make it clear that the applicant and the issuer may agree to almost any provision establishing the obligations of the issuer to the applicant. The last sentence of subsection (c) limits the power of the issuer to achieve that result by a nonnegotiated disclaimer or limitation of remedy.

What the issuer could achieve by an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (c) is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in "bad faith" or committed "gross negligence" is ineffective under Section 5-103(c). On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message believed in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a "substantially" though not "strictly" complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision.

Of course, no term in a letter of credit, whether incorporated by reference to practice rules or stated specifically, can free an issuer from a conflicting contractual obligation to its applicant. If, for example, an issuer promised its applicant that it would pay only against an inspection certificate of a particular company but failed to require such a certificate in its letter of credit or made the requirement only a nondocumentary condition that had to be disregarded, the issuer might be obliged to pay the beneficiary even though its payment might violate its contract with its applicant.

3. Parties should generally avoid modifying the definitions in Section 5-102. The effect of such an agreement is almost inevitably unclear. To say that something is a "guarantee" in the typical domestic transaction is to say that the parties intend that particular legal rules apply to it. By acknowledging that something is a guarantee, but asserting that it is to be treated as a "letter of credit," the parties leave a court uncertain about where the rules on guarantees stop and those concerning letters of credit begin.

4. Section 5-102(2) and (3) of Article 5 are omitted as unneeded; the omission does not change the law.

ANNOTATION

Annotator's note. Since § 4-5-103 is similar to § 4-5-102 as it existed prior to the 1996 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

For overview of the law and history concerning letters of credit, see Colo. Nat'l Bank v. Bd. of County Comm'rs, 634 P.2d 32 (Colo. 1981).

A document may be a letter of credit if it requires a documentary draft or documentary demand for payment or, if it contains neither requirement, but conspicuously declares itself to be a letter of credit. Raiffeisen-Zentralkasse Tirol v. First Nat'l Bank, 671 P.2d 1008 (Colo. App. 1983).

"Standby" letters of credit included in this article. Purported "standby" letters of credit, by

which the issuer claims to undertake only a secondary liability to pay damages resulting from its customers' failure to perform an underlying contract, which require documentary drafts and which are conspicuously entitled letters of credit, clearly fall within the scope of this article. Bd. of County Comm'rs v. Colo. Nat'l Bank, 43 Colo. App. 186, 607 P.2d 1010 (1979), aff'd in part and rev'd in part on other grounds, 634 P.2d 32 (Colo. 1981).

Letter of credit is separate and independent from underlying business transaction between the bank's customer and the beneficiary of the letter of credit. Colo. Nat'l Bank v. Bd. of County Comm'rs, 634 P.2d 32 (Colo. 1981).

Letters of credit not ultra vires. Letters of credit issued by a state bank, being authorized by § 11-7-107(2), and falling within the provisions of subsection (1), are binding, primary obligations, dependent solely on presentation of conforming documents, and are, therefore, not ultra vires. United Bank v. Quadrangle, Ltd., 42 Colo. App. 486, 596 P.2d 408 (1979).

Court's remedial powers limited by terms of letter of credit. Where the rights of all parties are defined and established under a letter of credit, a court may not fashion an equitable remedy to benefit a third party. Schmidt-Tiago Constr. Co. v. City of Colo. Springs, 633 P.2d 533 (Colo. App. 1981).

Surety contract not similar. An analogy between a surety contract and a letter of credit is not well taken. General Ins. Co. of Am. v. City of Colo. Springs, 638 P.2d 752 (Colo. 1981).

Applied in Dovenmuehle, Inc. v. East Bank, 38 Colo. App. 507, 563 P.2d 24 (1977); City of Colo. Springs v. General Ins. Co., 44 Colo. App. 174, 616 P.2d 147 (Colo. 1980).

4-5-104. Formal requirements. A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in section 4-5-108 (e).

Source: L. 96: Entire article R&RE, p. 194, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-104 as it existed prior to 1996.

OFFICIAL COMMENT

1. Neither Section 5-104 nor the definition of letter of credit in Section 5-102(a)(10) requires inclusion of all the terms that are normally contained in a letter of credit in order for an undertaking to be recognized as a letter of credit under Article 5. For example, a letter of credit will typically specify the amount available, the expiration date, the place where presentation should be made, and the documents that must be presented to entitle a person to honor. Undertakings that have the formalities required by Section 5-104 and meet the conditions specified in Section 5-102(a)(10) will be recognized as letters of credit even though they omit one or more of the items usually contained in a letter of credit.

2. The authentication specified in this section is authentication only of the identity of the issuer, confirmer, or adviser.

An authentication agreement may be by system rule, by standard practice, or by direct agreement between the parties. The reference to practice is intended to incorporate future developments in the UCP and other practice rules as well as those that may arise spontaneously in commercial practice.

3. Many banking transactions, including the issuance of many letters of credit, are now conducted mostly by electronic means. For example, S.W.I.F.T. is currently used to transmit letters of credit from issuing to advising banks. The letter of credit text so transmitted may be printed at the advising bank, stamped "original" and provided to the beneficiary in that form. The printed document may then be used as a way of controlling and recording payments and of recording and authorizing assignments of proceeds or transfers of rights under the letter of credit. Nothing in this section should be construed to conflict with that practice.

To be a record sufficient to serve as a letter of credit or other undertaking under this section, data must have a durability consistent with that function. Because consideration is not required for a binding letter of credit or similar undertaking (Section 5-105) yet those undertakings are to be strictly construed (Section 5-108), parties to a letter of credit transaction are especially dependent on the continued availability of the terms and conditions of the letter of credit or other undertaking. By declining to specify any particular medium in which the letter of credit must be established or communicated, Section 5-104 leaves room for future developments.

4-5-105. Consideration. Consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation.

Source: L. 96: Entire article R&RE, p. 194, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-105 as it existed prior to 1996.

OFFICIAL COMMENT

It is not to be expected that any issuer will issue its letter of credit without some form of remuneration. But it is not expected that the beneficiary will know what the issuer's remuneration was or whether in fact there was any identifiable remuneration in a given case. And it might be difficult for the beneficiary to prove the issuer's remuneration. This section dispenses with this proof and is consistent with the position of Lord Mansfield in Pillans v. Van Mierop, 97 Eng.Rep. 1035 (K.B. 1765) in making consideration irrelevant.

4-5-106. Issuance, amendment, cancellation, and duration. (a) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if it so provides.

(b) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(c) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one year after its stated date of issuance or, if none is stated, after the date on which it is issued.

(d) A letter of credit that states that it is perpetual expires five years after its stated date of issuance, or if none is stated, after the date on which it is issued.

Source: L. 96: Entire article R&RE, p. 194, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-106 as it existed prior to 1996.

OFFICIAL COMMENT

1. This section adopts the position taken by several courts, namely that letters of credit that are silent as to revocability are irrevocable. See, e.g., Weyerhaeuser Co. v. First Nat. Bank, 27 UCC Rep. Serv. 777 (S.D. Iowa 1979); West Va. Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107 (W.D. Pa. 1976). This is the position of the current UCP (500). Given the usual commercial understanding and purpose of letters of credit, revocable letters of credit offer unhappy possibilities for misleading the parties who deal with them.

2. A person can consent to an amendment by implication. For example, a beneficiary that tenders documents for honor that conform to an amended letter of credit but not to the original letter of credit has probably consented to the amendment. By the same token an applicant that has procured the issuance of a transferable letter of credit has consented to its transfer and to performance under the letter of credit by a person to whom the beneficiary's rights are duly transferred. If some, but not all of the persons involved in a letter of credit transaction consent to performance that does not strictly conform to the original letter of credit, those persons assume the risk that other nonconsenting persons may insist on strict compliance with the original letter of credit. Under subsection (b) those not consenting are not bound. For example, an issuer might agree to amend its letter of credit or honor documents presented after the expiration date in the belief that the applicant has consented or will consent to the amendment or will waive presentation after the original expiration date. If that belief is mistaken, the issuer is bound to the beneficiary by the terms of the letter of credit as amended or waived, even though it may be unable to recover from the applicant.

In general, the rights of a recognized transferee beneficiary cannot be altered without the transferee's consent, but the same is not true of the rights of assignees of proceeds from the beneficiary. When the beneficiary makes a complete transfer of its interest that is effective

under the terms for transfer established by the issuer, adviser, or other party controlling transfers, the beneficiary no longer has an interest in the letter of credit, and the transferee steps into the shoes of the beneficiary as the one with rights under the letter of credit. Section 5-102(a)(3). When there is a partial transfer, both the original beneficiary and the transferee beneficiary have an interest in performance of the letter of credit and each expects that its rights will not be altered by amendment unless it consents.

The assignee of proceeds under a letter of credit from the beneficiary enjoys no such expectation. Notwithstanding an assignee's notice to the issuer of the assignment of proceeds, the assignee is not a person protected by subsection (b). An assignee of proceeds should understand that its rights can be changed or completely extinguished by amendment or cancellation of the letter of credit. An assignee's claim is precarious, for it depends entirely upon the continued existence of the letter of credit and upon the beneficiary's preparation and presentation of documents that would entitle the beneficiary to honor under Section 5-108.

3. The issuer's right to cancel a revocable letter of credit does not free it from a duty to reimburse a nominated person who has honored, accepted, or undertaken a deferred obligation prior to receiving notice of the amendment or cancellation. Compare UCP Article 8.

4. Although all letters of credit should specify the date on which the issuer's engagement expires, the failure to specify an expiration date does not invalidate the letter of credit, or diminish or relieve the obligation of any party with respect to the letter of credit. A letter of credit that may be revoked or terminated at the discretion of the issuer by notice to the beneficiary is not "perpetual."

4-5-107. Confirmer, nominated person, and adviser. (a) A confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmer also has rights against and obligations to the issuer as if the issuer were an applicant and the confirmer had issued the letter of credit at the request and for the account of the issuer.

(b) A nominated person who is not a confirmer is not obligated to honor or otherwise give value for a presentation.

(c) A person requested to advise may decline to act as an adviser. An adviser that is not a confirmer is not obligated to honor or give value for a presentation. An adviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment, or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation, or amendment is enforceable as issued.

(d) A person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice has the rights and obligations of an adviser under subsection (c) of this section. The terms in the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment, or advice received by the person who so notifies.

Source: L. 96: Entire article R&RE, p. 194, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-107 as it existed prior to 1996.

OFFICIAL COMMENT

1. A confirmer has the rights and obligations identified in Section 5-108. Accordingly, unless the context otherwise requires, the terms "confirmer" and "confirmation" should be read into this article wherever the terms "issuer" and "letter of credit" appear.

A confirmer that has paid in accordance with the terms and conditions of the letter of credit is entitled to reimbursement by the issuer even if the beneficiary committed fraud (see Section 5-109(a)(1)(ii)) and, in that sense, has greater rights against the issuer than the beneficiary has. To be entitled to reimbursement from the issuer under the typical confirmed letter of credit, the confirmer must submit conforming documents, but the confirmer's presentation to the issuer need not be made before the expiration date of the letter of credit.

A letter of credit confirmation has been analogized to a guarantee of issuer performance, to a parallel letter of credit issued by the confirmer for the account of the issuer or the letter of credit applicant or both, and to a back-to-back letter of credit in which the confirmer is a kind of beneficiary of the original issuer's letter of credit. Like letter of credit undertakings, confirmations

are both unique and flexible, so that no one of these analogies is perfect, but unless otherwise indicated in the letter of credit or confirmation, a confirmer should be viewed by the letter of credit issuer and the beneficiary as an issuer of a parallel letter of credit for the account of the original letter of credit issuer. Absent a direct agreement between the applicant and a confirmer, normally the obligations of a confirmer are to the issuer not the applicant, but the applicant might have a right to injunction against a confirmer under Section 5-109 or warranty claim under Section 5-110, and either might have claims against the other under Section 5-117.

2. No one has a duty to advise until that person agrees to be an adviser or undertakes to act in accordance with the instructions of the issuer. Except where there is a prior agreement to serve or where the silence of the adviser would be an acceptance of an offer to contract, a person's failure to respond to a request to advise a letter of credit does not in and of itself create any liability, nor does it establish a relationship of issuer and adviser between the two. Since there is no duty to advise a letter of credit in the absence of a prior agreement, there can be no duty to advise it timely or at any particular time. When the adviser manifests its agreement to advise by actually doing so (as is normally the case), the adviser cannot have violated any duty to advise in a timely way. This analysis is consistent with the result of Sound of Market Street v. Continental Bank International, 819 F.2d 384 (3d Cir. 1987) which held that there is no such duty. This section takes no position on the reasoning of that case, but does not overrule the result. By advising or agreeing to advise a letter of credit, the adviser assumes a duty to the issuer and to the beneficiary accurately to report what it has received from the issuer, but, beyond determining the apparent authenticity of the letter, an adviser has no duty to investigate the accuracy of the message it has received from the issuer. "Checking" the apparent authenticity of the request to advise means only that the prospective adviser must attempt to authenticate the message (e.g., by "testing" the telex that comes from the purported issuer), and if it is unable to authenticate the message must report that fact to the issuer and, if it chooses to advise the message, to the beneficiary. By proper agreement, an adviser may disclaim its obligation under this section.

3. An issuer may issue a letter of credit which the adviser may advise with different terms. The issuer may then believe that it has undertaken a certain engagement, yet the text in the hands of the beneficiary will contain different terms, and the beneficiary would not be entitled to honor if the documents it submitted did not comply with the terms of the letter of credit as originally issued. On the other hand, if the adviser also confirmed the letter of credit, then as a confirmer it will be independently liable on the letter of credit as advised and confirmed. If in that situation the beneficiary's ultimate presentation entitled it to honor under the terms of the confirmation but not under those in the original letter of credit, the confirmer would have to honor but might not be entitled to reimbursement from the issuer.

4. When the issuer nominates another person to "pay," "negotiate," or otherwise to take up the documents and give value, there can be confusion about the legal status of the nominated person. In rare cases the person might actually be an agent of the issuer and its act might be the act of the issuer itself. In most cases the nominated person is not an agent of the issuer and has no authority to act on the issuer's behalf. Its "nomination" allows the beneficiary to present to it and earns it certain rights to payment under Section 5-109 that others do not enjoy. For example, when an issuer issues a "freely negotiable credit," it contemplates that banks or others might take up documents under that credit and advance value against them, and it is agreeing to pay those persons but only if the presentation to the issuer made by the nominated person complies with the credit. Usually there will be no agreement to pay, negotiate, or to serve in any other capacity by the nominated person, therefore the nominated person will have the right to decline to take the documents. It may return them or agree merely to act as a forwarding agent for the documents but without giving value against them or taking any responsibility for their conformity to the letter of credit.

4-5-108. Issuer's rights and obligations. (a) Except as otherwise provided in section 4-5-109, an issuer shall honor a presentation that, as determined by the standard practice referred to in subsection (e) of this section, appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in section 4-5-113 and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear so to comply.

(b) An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents:

(1) To honor;

(2) If the letter of credit provides for honor to be completed more than seven business days after presentation, to accept a draft or incur a deferred obligation; or

(3) To give notice to the presenter of discrepancies in the presentation.

(c) Except as otherwise provided in subsection (d) of this section, an issuer is precluded from asserting as a basis for dishonor any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given.

(d) Failure to give the notice specified in subsection (b) of this section or to mention fraud, forgery, or expiration in the notice does not preclude the issuer from asserting as a basis for dishonor fraud or forgery as described in section 4-5-109 (a) or expiration of the letter of credit before presentation.

(e) An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(f) An issuer is not responsible for:

(1) The performance or nonperformance of the underlying contract, arrangement, or transaction;

(2) An act or omission of others; or

(3) Observance or knowledge of the usage of a particular trade other than the standard practice referred to in subsection (e) of this section.

(g) If an undertaking constituting a letter of credit under section 4-5-102 (a) (10) contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(h) An issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.

(i) An issuer that has honored a presentation as permitted or required by this article:

(1) Is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds;

(2) Takes the documents free of claims of the beneficiary or presenter;

(3) Is precluded from asserting a right of recourse on a draft under sections 4-3-414 and 4-3-415;

(4) Except as otherwise provided in sections 4-5-110 and 4-5-117, is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender which are apparent on the face of the presentation; and

(5) Is discharged to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of a beneficiary was forged.

Source: L. 96: Entire article R&RE, p. 195, § 1, effective July 1.

Editor's note: This section is similar to former §§ 4-5-109 and 4-5-112 as they existed prior to 1996.

OFFICIAL COMMENT

1. This section combines some of the duties previously included in Sections 5-114 and 5-109. Because a confirmer has the rights and duties of an issuer, this section applies equally to a confirmer and an issuer. See Section 5-107(a).

The standard of strict compliance governs the issuer's obligation to the beneficiary and to the applicant. By requiring that a "presentation" appear strictly to comply, the section requires not only that the documents themselves appear on their face strictly to comply, but also that the other terms of the letter of credit such as those dealing with the time and place of presentation are strictly complied with. Typically, a letter of credit will provide that presentation is timely if made to the issuer, confirmer, or any other nominated person prior to expiration of the letter of credit. Accordingly, a nominated person that has honored a demand or otherwise given value before expiration will have a right to reimbursement from the issuer even though presentation to the issuer is made after the expiration of the letter of credit. Conversely, where the beneficiary negotiates documents to one who is not a nominated person, the beneficiary or that person acting on behalf of the beneficiary must make presentation to a nominated person, confirmer, or issuer prior to the expiration date.

This section does not impose a bifurcated standard under which an issuer's right to reim-

bursement might be broader than a beneficiary's right to honor. However, the explicit deference to standard practice in Section 5-108(a) and (e) and elsewhere expands issuers' rights of reimbursement where that practice so provides. Also, issuers can and often do contract with their applicants for expanded rights of reimbursement. Where that is done, the beneficiary will have to meet a more stringent standard of compliance as to the issuer than the issuer will have to meet as to the applicant. Similarly, a nominated person may have reimbursement and other rights against the issuer based on this article, the UCP, bank-to-bank reimbursement rules, or other agreement or undertaking of the issuer. These rights may allow the nominated person to recover from the issuer even when the nominated person would have no right to obtain honor under the letter of credit.

The section adopts strict compliance, rather than the standard that commentators have called "substantial compliance," the standard arguably applied in Banco Espanol de Credito v. State Street Bank and Trust Company, 385 F.2d 230 (1st Cir. 1967) and Flagship Cruises Ltd. v. New England Merchants Nat. Bank, 569 F.2d 699 (1st Cir. 1978). Strict compliance does not mean slavish conformity to the terms of the letter of credit. For example, standard practice (what issuers do) may recognize certain presentations as complying that an unschooled layman would regard as discrepant. By adopting standard practice as a way of measuring strict compliance, this article indorses the conclusion of the court in New Braunfels Nat. Bank v. Odiorne, 780 S.W.2d 313 (Tex.Ct.App. 1989) (beneficiary could collect when draft requested payment on 'Letter of Credit No. 86-122-5' and letter of credit specified 'Letter of Credit No. 86-122-S' holding strict compliance does not demand oppressive perfectionism). The section also indorses the result in Tosco Corp. v. Federal Deposit Insurance Corp., 723 F.2d 1242 (6th Cir. 1983). The letter of credit in that case called for "drafts Drawn under Bank of Clarksville Letter of Credit Number 105." The draft presented stated "drawn under Bank of Clarksville, Clarksville, Tennessee letter of Credit No. 105." The court correctly found that despite the change of upper case "L" to a lower case "l" and the use of the word "No." instead of "Number," and despite the addition of the words "Clarksville, Tennessee," the presentation conformed. Similarly a document addressed by a foreign person to General Motors as "Jeneral Motors" would strictly conform in the absence of other defects.

Identifying and determining compliance with standard practice are matters of interpretation for the court, not for the jury. As with similar rules in Sections 4A-202(c) and 2-302, it is hoped that there will be more consistency in the outcomes and speedier resolution of disputes if the responsibility for determining the nature and scope of standard practice is granted to the court, not to a jury. Granting the court authority to make these decisions will also encourage the salutary practice of courts' granting summary judgment in circumstances where there are no significant factual disputes. The statute encourages outcomes such as American Coleman Co. v. Intrawest Bank, 887 F.2d 1382 (10th Cir. 1989), where summary judgment was granted.

In some circumstances standards may be established between the issuer and the applicant by agreement or by custom that would free the issuer from liability that it might otherwise have. For example, an applicant might agree that the issuer would have no duty whatsoever to examine documents on certain presentations (e.g., those below a certain dollar amount). Where the transaction depended upon the issuer's payment in a very short time period (e.g., on the same day or within a few hours of presentation), the issuer and the applicant might agree to reduce the issuer's responsibility for failure to discover discrepancies. By the same token, an agreement between the applicant and the issuer might permit the issuer to examine documents exclusively by electronic or electro-optical means. Neither those agreements nor others like them explicitly made by issuers and applicants violate the terms of Section 5-108(a) or (b) or Section 5-103(c).

2. Section 5-108(a) balances the need of the issuer for time to examine the documents against the possibility that the examiner (at the urging of the applicant or for fear that it will not be reimbursed) will take excessive time to search for defects. What is a "reasonable time" is not extended to accommodate an issuer's procuring a waiver from the applicant. See Article 14c of the UCP.

Under both the UCC and the UCP the issuer has a reasonable time to honor or give notice. The outside limit of that time is measured in business days under the UCC and in banking days under the UCP, a difference that will rarely be significant. Neither business nor banking days are defined in Article 5, but a court may find useful analogies in Regulation CC, 12 CFR 229.2, in state law outside of the Uniform Commercial Code, and in Article 4.

Examiners must note that the seven-day period is not a safe harbor. The time within which the issuer must give notice is the lesser of a reasonable time or seven business days. Where there are few documents (as, for example, with the mine run standby letter of credit), the reasonable time would be less than seven days. If more than a reasonable time is consumed in examination, no timely notice is possible. What is a "reasonable time" is to be determined by examining the behavior of those in the business of examining documents, mostly banks. Absent prior agreement of the issuer, one could not

expect a bank issuer to examine documents while the beneficiary waited in the lobby if the normal practice was to give the documents to a person who had the opportunity to examine those together with many others in an orderly process. That the applicant has not yet paid the issuer or that the applicant's account with the issuer is insufficient to cover the amount of the draft is not a basis for extension of the time period.

This section does not preclude the issuer from contacting the applicant during its examination; however, the decision to honor rests with the issuer, and it has no duty to seek a waiver from the applicant or to notify the applicant of receipt of the documents. If the issuer dishonors a conforming presentation, the beneficiary will be entitled to the remedies under Section 5-111, irrespective of the applicant's views.

Even though the person to whom presentation is made cannot conduct a reasonable examination of documents within the time after presentation and before the expiration date, presentation establishes the parties' rights. The beneficiary's right to honor or the issuer's right to dishonor arises upon presentation at the place provided in the letter of credit even though it might take the person to whom presentation has been made several days to determine whether honor or dishonor is the proper course. The issuer's time for honor or giving notice of dishonor may be extended or shortened by a term in the letter of credit. The time for the issuer's performance may be otherwise modified or waived in accordance with Section 5-106.

The issuer's time to inspect runs from the time of its "receipt of documents." Documents are considered to be received only when they are received at the place specified for presentation by the issuer or other party to whom presentation is made.

Failure of the issuer to act within the time permitted by subsection (b) constitutes dishonor. Because of the preclusion in subsection (c) and the liability that the issuer may incur under Section 5-111 for wrongful dishonor, the effect of such a silent dishonor may ultimately be the same as though the issuer had honored, i.e., it may owe damages in the amount drawn but unpaid under the letter of credit.

3. The requirement that the issuer send notice of the discrepancies or be precluded from asserting discrepancies is new to Article 5. It is taken from the similar provision in the UCP and is intended to promote certainty and finality.

The section thus substitutes a strict preclusion principle for the doctrines of waiver and estoppel that might otherwise apply under Section 1-103. It rejects the reasoning in Flagship Cruises Ltd. v. New England Merchants' Nat. Bank, 569 F.2d 699 (1st Cir. 1978) and Wing On Bank Ltd. v. American Nat. Bank & Trust Co., 457 F.2d 328 (5th Cir. 1972) where the issuer was held to be estopped only if the beneficiary relied on the issuer's failure to give notice.

Assume, for example, that the beneficiary presented documents to the issuer shortly before the letter of credit expired, in circumstances in which the beneficiary could not have cured any discrepancy before expiration. Under the reasoning of Flagship and Wing On, the beneficiary's inability to cure, even if it had received notice, would absolve the issuer of its failure to give notice. The virtue of the preclusion obligation adopted in this section is that it forecloses litigation about reliance and detriment.

Even though issuers typically give notice of the discrepancy of tardy presentation when presentation is made after the expiration of a credit, they are not required to give that notice and the section permits them to raise late presentation as a defect despite their failure to give that notice.

4. To act within a reasonable time, the issuer must normally give notice without delay after the examining party makes its decision. If the examiner decides to dishonor on the first day, it would be obliged to notify the beneficiary shortly thereafter, perhaps on the same business day. This rule accepts the reasoning in cases such as Datapoint Corp. v. M & I Bank, 665 F. Supp. 722 (W.D. Wis. 1987) and Esso Petroleum Canada, Div. of Imperial Oil, Ltd. v. Security Pacific Bank, 710 F. Supp. 275 (D. Ore. 1989).

The section deprives the examining party of the right simply to sit on a presentation that is made within seven days of expiration. The section requires the examiner to examine the documents and make a decision and, having made a decision to dishonor, to communicate promptly with the presenter. Nevertheless, a beneficiary who presents documents shortly before the expiration of a letter of credit runs the risk that it will never have the opportunity to cure any discrepancies.

5. Confirmers, other nominated persons, and collecting banks acting for beneficiaries can be presenters and, when so, are entitled to the notice provided in subsection (b). Even nominated persons who have honored or given value against an earlier presentation of the beneficiary and are themselves seeking reimbursement or honor need notice of discrepancies in the hope that they may be able to procure complying documents. The issuer has the obligations imposed by this section whether the issuer's performance is characterized as "reimbursement" of a nominated person or as "honor."

6. In many cases a letter of credit authorizes presentation by the beneficiary to someone other than the issuer. Sometimes that person is identified as a "payor" or "paying bank," or as an "acceptor" or "accepting bank," in other cases as a "negotiating bank," and in other cases there will be no specific designation. The section does not impose any duties on a person other than the issuer or confirmer, however a nominated per-

son or other person may have liability under this article or at common law if it fails to perform an express or implied agreement with the beneficiary.

7. The issuer's obligation to honor runs not only to the beneficiary but also to the applicant. It is possible that an applicant who has made a favorable contract with the beneficiary will be injured by the issuer's wrongful dishonor. Except to the extent that the contract between the issuer and the applicant limits that liability, the issuer will have liability to the applicant for wrongful dishonor under Section 5-111 as a matter of contract law. A good faith extension of the time in Section 5-108(b) by agreement between the issuer and beneficiary binds the applicant even if the applicant is not consulted or does not consent to the extension.

The issuer's obligation to dishonor when there is no apparent compliance with the letter of credit runs only to the applicant. No other party to the transaction can complain if the applicant waives compliance with terms or conditions of the letter of credit or agrees to a less stringent standard for compliance than that supplied by this article. Except as otherwise agreed with the applicant, an issuer may dishonor a noncomplying presentation despite an applicant's waiver.

Waiver of discrepancies by an issuer or an applicant in one or more presentations does not waive similar discrepancies in a future presentation. Neither the issuer nor the beneficiary can reasonably rely upon honor over past waivers as a basis for concluding that a future defective presentation will justify honor. The reasoning of Courtaulds of North America Inc. v. North Carolina Nat. Bank, 528 F.2d 802 (4th Cir. 1975) is accepted and that expressed in Schweibish v. Pontchartrain State Bank, 389 So.2d 731 (La.App. 1980) and Titanium Metals Corp. v. Space Metals, Inc., 529 P.2d 431 (Utah 1974) is rejected.

8. The standard practice referred to in subsection (e) includes (i) international practice set forth in or referenced by the Uniform Customs and Practice, (ii) other practice rules published by associations of financial institutions, and (iii) local and regional practice. It is possible that standard practice will vary from one place to another. Where there are conflicting practices, the parties should indicate which practice governs their rights. A practice may be overridden by agreement or course of dealing. See Section 1-205(4).

9. The responsibility of the issuer under a letter of credit is to examine documents and to make a prompt decision to honor or dishonor based upon that examination. Nondocumentary conditions have no place in this regime and are better accommodated under contract or suretyship law and practice. In requiring that nondocumentary conditions in letters of credit be ignored as surplusage, Article 5 remains aligned with the UCP (see UCP 500 Article 13c), approves cases like Pringle-Associated Mortgage Corp. v. Southern National Bank, 571 F.2d 871, 874 (5th Cir. 1978), and rejects the reasoning in cases such as Sherwood & Roberts, Inc. v. First Security Bank, 682 P.2d 149 (Mont. 1984).

Subsection (g) recognizes that letters of credit sometimes contain nondocumentary terms or conditions. Conditions such as a term prohibiting "shipment on vessels more than 15 years old," are to be disregarded and treated as surplusage. Similarly, a requirement that there be an award by a "duly appointed arbitrator" would not require the issuer to determine whether the arbitrator had been "duly appointed." Likewise a term in a standby letter of credit that provided for differing forms of certification depending upon the particular type of default does not oblige the issuer independently to determine which kind of default has occurred. These conditions must be disregarded by the issuer. Where the nondocumentary conditions are central and fundamental to the issuer's obligation (as for example a condition that would require the issuer to determine in fact whether the beneficiary had performed the underlying contract or whether the applicant had defaulted) their inclusion may remove the undertaking from the scope of Article 5 entirely. See Section 5-102(a)(10) and Comment 6 to Section 5-102.

Subsection (g) would not permit the beneficiary or the issuer to disregard terms in the letter of credit such as place, time, and mode of presentation. The rule in subsection (g) is intended to prevent an issuer from deciding or even investigating extrinsic facts, but not from consulting the clock, the calendar, the relevant law and practice, or its own general knowledge of documentation or transactions of the type underlying a particular letter of credit.

Even though nondocumentary conditions must be disregarded in determining compliance of a presentation (and thus in determining the issuer's duty to the beneficiary), an issuer that has promised its applicant that it will honor only on the occurrence of those nondocumentary conditions may have liability to its applicant for disregarding the conditions.

10. Subsection (f) condones an issuer's ignorance of "any usage of a particular trade"; that trade is the trade of the applicant, beneficiary, or others who may be involved in the underlying transaction. The issuer is expected to know usage that is commonly encountered in the course of document examination. For example, an issuer should know the common usage with respect to documents in the maritime shipping trade but would not be expected to understand synonyms used in a particular trade for product descriptions appearing in a letter of credit or an invoice.

11. Where the issuer's performance is the delivery of an item of value other than money, the applicant's reimbursement obligation would be to make the "item of value" available to the issuer.

12. An issuer is entitled to reimbursement from the applicant after honor of a forged or fraudulent drawing if honor was permitted under Section 5-109(a).

13. The last clause of Section 5-108(i)(5) deals with a special case in which the fraud is not committed by the beneficiary, but is committed by a stranger to the transaction who forges the beneficiary's signature. If the issuer pays against documents on which a required signature of the beneficiary is forged, it remains liable to the true beneficiary.

4-5-109. Fraud and forgery. (a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:

(1) The issuer shall honor the presentation, if honor is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and

(2) The issuer, acting in good faith, may honor or dishonor the presentation in any other case.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(1) The relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;

(2) A beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;

(3) All of the conditions to entitle a person to the relief under the law of this State have been met; and

(4) On the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under subsection (a) (1) of this section.

Source: L. 96: Entire article R&RE, p. 196, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-114 as it existed prior to 1996.

OFFICIAL COMMENT

1. This recodification makes clear that fraud must be found either in the documents or must have been committed by the beneficiary on the issuer or applicant. See Cromwell v. Commerce & Energy Bank, 464 So.2d 721 (La. 1985).

Secondly, it makes clear that fraud must be "material." Necessarily courts must decide the breadth and width of "materiality." The use of the word requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in the underlying transaction. Assume, for example, that the beneficiary has a contract to deliver 1,000 barrels of salad oil. Knowing that it has delivered only 998, the beneficiary nevertheless submits an invoice showing 1,000 barrels. If two barrels in a 1,000 barrel shipment would be an insubstantial and immaterial breach of the underlying contract, the beneficiary's act, though possibly fraudulent, is not materially so and would not justify an injunction. Conversely, the knowing submission of those invoices upon delivery of only five barrels would be materially fraudulent. The courts must examine the underlying transaction when there is an allegation of material fraud, for only by examining that transaction can one determine whether a document is fraudulent or the beneficiary has committed fraud and, if so, whether the fraud was material.

Material fraud by the beneficiary occurs only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support such a right to honor. The section indorses articulations such as those stated in Intraworld Indus. v. Girard Trust Bank, 336 A.2d 316 (Pa. 1975), Roman Ceramics Corp. v. People's Nat. Bank, 714 F.2d 1207 (3d Cir. 1983), and similar decisions and embraces certain decisions under Section 5-114 that relied upon the phrase "fraud in the transaction." Some of these decisions have been summarized as follows in Ground Air Transfer v. Westate's Airlines, 899 F.2d 1269, 1272-73 (1st Cir. 1990):

We have said throughout that courts may not "normally" issue an injunction because of an important exception to the general "no injunction" rule. The exception, as we also explained in Itek, 730 F.2d at 24-25, concerns "fraud" so serious as to make it obviously pointless and unjust to permit the beneficiary to obtain the money. Where the circumstances "plainly" show that the underlying contract forbids the beneficiary to call a letter of credit, Itek, 730 F.2d at 24; where they show that the contract deprives the beneficiary of even a "colorable" right to do so, id., at 25; where the contract and circumstances reveal that the beneficiary's demand for payment has "absolutely no basis in fact," id.; see Dynamics Corp. of America, 356 F. Supp. at 999; where the beneficiary's conduct has "so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served," Itek, 730 F.2d at 25 (quoting Roman Ceramics Corp. v. Peoples National Bank, 714 F.2d 1207, 1212 n.12, 1215 (3d Cir. 1983) (quoting Intraworld Indus., 336 A.2d at 324-25)); then a court may enjoin payment.

2. Subsection (a)(2) makes clear that the issuer may honor in the face of the applicant's claim of fraud. The subsection also makes clear what was not stated in former Section 5-114, that the issuer may dishonor and defend that dishonor by showing fraud or forgery of the kind stated in subsection (a). Because issuers may be liable for wrongful dishonor if they are unable to prove forgery or material fraud, presumably most issuers will choose to honor despite applicant's claims of fraud or forgery unless the applicant procures an injunction. Merely because the issuer has a right to dishonor and to defend that dishonor by showing forgery or material fraud does not mean it has a duty to the applicant to dishonor. The applicant's normal recourse is to procure an injunction, if the applicant is unable to procure an injunction, it will have a claim against the issuer only in the rare case in which it can show that the issuer did not honor in good faith.

3. Whether a beneficiary can commit fraud by presenting a draft under a clean letter of credit (one calling only for a draft and no other documents) has been much debated. Under the current formulation it would be possible but difficult for there to be fraud in such a presentation. If the applicant were able to show that the beneficiary were committing material fraud on the applicant in the underlying transaction, then payment would facilitate a material fraud by the beneficiary on the applicant and honor could be enjoined. The courts should be skeptical of claims of fraud by one who has signed a "suicide" or clean credit and thus granted a beneficiary the right to draw by mere presentation of a draft.

4. The standard for injunctive relief is high, and the burden remains on the applicant to show, by evidence and not by mere allegation, that such relief is warranted. Some courts have enjoined payments on letters of credit on insufficient showing by the applicant. For example, in Griffin Cos. v. First Nat. Bank, 374 N.W.2d 768 (Minn. App. 1985), the court enjoined payment under a standby letter of credit, basing its decision on plaintiff's allegation, rather than competent evidence, of fraud.

There are at least two ways to prohibit injunctions against honor under this section after acceptance of a draft by the issuer. First is to define honor (see Section 5-102(a)(8)) in the particular letter of credit to occur upon acceptance and without regard to later payment of the acceptance. Second is explicitly to agree that the applicant has no right to an injunction after acceptance — whether or not the acceptance constitutes honor.

5. Although the statute deals principally with injunctions against honor, it also cautions against granting "similar relief" and the same principles apply when the applicant or issuer attempts to achieve the same legal outcome by injunction against presentation (see Ground Air Transfer Inc. v. Westates Airlines, Inc., 899 F.2d 1269 (1st Cir. 1990)), interpleader, declaratory judgment, or attachment. These attempts should face the same obstacles that face efforts to enjoin the issuer from paying. Expanded use of any of these devices could threaten the independence principle just as much as injunctions against honor. For that reason courts should have the same hostility to them and place the same restrictions on their use as would be applied to injunctions against honor. Courts should not allow the "sacred cow of equity to trample the tender vines of letter of credit law."

6. Section 5-109(a)(1) also protects specified third parties against the risk of fraud. By issuing a letter of credit that nominates a person to negotiate or pay, the issuer (ultimately the applicant) induces that nominated person to give value and thereby assumes the risk that a draft drawn under the letter of credit will be transferred to one with a status like that of a holder in

due course who deserves to be protected against a fraud defense.

7. The "loss" to be protected against — by bond or otherwise under subsection (b)(2) — includes incidental damages. Among those are legal fees that might be incurred by the beneficiary or issuer in defending against an injunction action.

4-5-110. Warranties. (a) If its presentation is honored, the beneficiary warrants:

(1) To the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in section 4-5-109 (a); and

(2) To the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(b) The warranties in subsection (a) of this section are in addition to warranties arising under articles 3, 4, 7, and 8 of this title because of the presentation or transfer of documents covered by any of those articles.

Source: L. 96: Entire article R&RE, p. 196, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-111 as it existed prior to 1996.

OFFICIAL COMMENT

1. Since the warranties in subsection (a) are not given unless a letter of credit has been honored, no breach of warranty under this subsection can be a defense to dishonor by the issuer. Any defense must be based on Section 5-108 or 5-109 and not on this section. Also, breach of the warranties by the beneficiary in subsection (a) cannot excuse the applicant's duty to reimburse.

2. The warranty in Section 5-110(a)(2) assumes that payment under the letter of credit is final. It does not run to the issuer, only to the applicant. In most cases the applicant will have a direct cause of action for breach of the underlying contract. This warranty has primary application in standby letters of credit or other circumstances where the applicant is not a party to an underlying contract with the beneficiary. It is not a warranty that the statements made on the presentation of the documents presented are truthful nor is it a warranty that the documents strictly comply under Section 5-108(a). It is a warranty that the beneficiary has performed all the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor. If, for example, an underlying sales contract authorized the beneficiary to draw only upon "due performance" and the beneficiary drew even though it had breached the underlying contract by delivering defective goods, honor of its draw would break the warranty. By the same token, if the underlying contract authorized the beneficiary to draw only upon actual default or upon its or a third party's determination of default by the applicant and if the beneficiary drew in violation of its authorization, then upon honor of its draw the warranty would be breached. In many cases, therefore, the documents presented to the issuer will contain inaccurate statements (concerning the goods delivered or concerning default or other matters), but the breach of warranty arises not because the statements are untrue but because the beneficiary's drawing violated its express or implied obligations in the underlying transaction.

3. The damages for breach of warranty are not specified in Section 5-111. Courts may find damage analogies in Section 2-714 in Article 2 and in warranty decisions under Articles 3 and 4.

Unlike wrongful dishonor cases — where the damages usually equal the amount of the draw — the damages for breach of warranty will often be much less than the amount of the draw, sometimes zero. Assume a seller entitled to draw only on proper performance of its sales contract. Assume it breaches the sales contract in a way that gives the buyer a right to damages but no right to reject. The applicant's damages for breach of the warranty in subsection (a)(2) are limited to the damages it could recover for breach of the contract of sale. Alternatively assume an underlying agreement that authorizes a beneficiary to draw only the "amount in default." Assume a default of $200,000 and a draw of $500,000. The damages for breach of warranty would be no more than $300,000.

4-5-111. Remedies. (a) If an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor, or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonor or repudiation. If the issuer's obligation under the letter of credit is not for the payment of money, the claimant may obtain specific performance or, at

the claimant's election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. The claimant is not obligated to take action to avoid damages that might be due from the issuer under this subsection (a). If, although not obligated to do so, the claimant avoids damages, the claimant's recovery from the issuer must be reduced by the amount of damages avoided. The issuer has the burden of proving the amount of damages avoided. In the case of repudiation the claimant need not present any document.

(b) If an issuer wrongfully dishonors a draft or demand presented under a letter of credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach.

(c) If an adviser or nominated person other than a confirmer breaches an obligation under this article or an issuer breaches an obligation not covered in subsection (a) or (b) of this section, a person to whom the obligation is owed may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of the confirmation, a confirmer has the liability of an issuer specified in this subsection (c) and subsections (a) and (b) of this section.

(d) An issuer, nominated person, or adviser who is found liable under subsection (a), (b), or (c) of this section shall pay interest on the amount owed thereunder from the date of wrongful dishonor or other appropriate date.

(e) Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article.

(f) Damages that would otherwise be payable by a party for breach of an obligation under this article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated.

Source: L. 96: Entire article R&RE, p. 197, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-115 as it existed prior to 1996.

OFFICIAL COMMENT

1. The right to specific performance is new. The express limitation on the duty of the beneficiary to mitigate damages adopts the position of certain courts and commentators. Because the letter of credit depends upon speed and certainty of payment, it is important that the issuer not be given an incentive to dishonor. The issuer might have an incentive to dishonor if it could rely on the burden of mitigation falling on the beneficiary, (to sell goods and sue only for the difference between the price of the goods sold and the amount due under the letter of credit). Under the scheme contemplated by Section 5-111(a), the beneficiary would present the documents to the issuer. If the issuer wrongfully dishonored, the beneficiary would have no further duty to the issuer with respect to the goods covered by documents that the issuer dishonored and returned. The issuer thus takes the risk that the beneficiary will let the goods rot or be destroyed. Of course the beneficiary may have a duty of mitigation to the applicant arising from the underlying agreement, but the issuer would not have the right to assert that duty by way of defense or setoff. See Section 5-117(d). If the beneficiary sells the goods covered by dishonored documents or if the beneficiary sells a draft after acceptance but before dishonor by the issuer, the net amount so gained should be subtracted from the amount of the beneficiary's damages — at least where the damage claim against the issuer equals or exceeds the damage suffered by the beneficiary. If, on the other hand, the beneficiary suffers damages in an underlying transaction in an amount that exceeds the amount of the wrongfully dishonored demand (e.g., where the letter of credit does not cover 100 percent of the underlying obligation), the damages avoided should not necessarily be deducted from the beneficiary's claim against the issuer. In such a case, the damages would be the lesser of (i) the amount recoverable in the absence of mitigation (that is, the amount that is subject to the dishonor or repudiation plus any incidental damages) and (ii) the damages remaining after deduction for the amount of damages actually avoided.

A beneficiary need not present documents as a condition of suit for anticipatory repudiation, but if a beneficiary could never have obtained documents necessary for a presentation conforming to the letter of credit, the beneficiary cannot recover for anticipatory repudiation of the letter of credit. Doelger v. Battery Park

Bank, 201 A.D. 515, 194 N.Y.S. 582 (1922) and Decor by Nikkei Int'l, Inc. v. Federal Republic of Nigeria, 497 F.Supp. 893 (S.D.N.Y. 1980), aff'd, 647 F.2d 300 (2d Cir. 1981), cert. denied, 454 U.S. 1148 (1982). The last sentence of subsection (c) does not expand the liability of a confirmer to persons to whom the confirmer would not otherwise be liable under Section 5-107.

Almost all letters of credit, including those that call for an acceptance, are "obligations to pay money" as that term is used in Section 5-111(a).

2. What damages "result" from improper honor is for the courts to decide. Even though an issuer pays a beneficiary in violation of Section 5-108(a) or of its contract with the applicant, it may have no liability to an applicant. If the underlying contract has been fully performed, the applicant may not have been damaged by the issuer's breach. Such a case would occur when A contracts for goods at $100 per ton, but, upon delivery, the market value of conforming goods has decreased to $25 per ton. If the issuer pays over discrepancies, there should be no recovery by A for the price differential if the issuer's breach did not alter the applicant's obligation under the underlying contract, i.e., to pay $100 per ton for goods now worth $25 per ton. On the other hand, if the applicant intends to resell the goods and must itself satisfy the strict compliance requirements under a second letter of credit in connection with its sale, the applicant may be damaged by the issuer's payment despite discrepancies because the applicant itself may then be unable to procure honor on the letter of credit where it is the beneficiary, and may be unable to mitigate its damages by enforcing its rights against others in the underlying transaction. Note that an issuer found liable to its applicant may have recourse under Section 5-117 by subrogation to the applicant's claim against the beneficiary or other persons.

One who inaccurately advises a letter of credit breaches its obligation to the beneficiary, but may cause no damage. If the beneficiary knows the terms of the letter of credit and understands the advice to be inaccurate, the beneficiary will have suffered no damage as a result of the adviser's breach.

3. Since the confirmer has the rights and duties of an issuer, in general it has an issuer's liability, see subsection (c). The confirmer is usually a confirming bank. A confirming bank often also plays the role of an adviser. If it breaks its obligation to the beneficiary, the confirming bank may have liability as an issuer or, depending upon the obligation that was broken, as an adviser. For example, a wrongful dishonor would give it liability as an issuer under Section 5-111(a). On the other hand a confirming bank that broke its obligation to advise the credit but did not commit wrongful dishonor would be treated under Section 5-111(c).

4. Consequential damages for breach of obligations under this article are excluded in the belief that these damages can best be avoided by the beneficiary or the applicant and out of the fear that imposing consequential damages on issuers would raise the cost of the letter of credit to a level that might render it uneconomic. A fortiori punitive and exemplary damages are excluded, however, this section does not bar recovery of consequential or even punitive damages for breach of statutory or common law duties arising outside of this article.

5. The section does not specify a rate of interest. It leaves the setting of the rate to the court. It would be appropriate for a court to use the rate that would normally apply in that court in other situations where interest is imposed by law.

6. The court must award attorney's fees to the prevailing party, whether that party is an applicant, a beneficiary, an issuer, a nominated person, or adviser. Since the issuer may be entitled to recover its legal fees and costs from the applicant under the reimbursement agreement, allowing the issuer to recover those fees from a losing beneficiary may also protect the applicant against undeserved losses. The party entitled to attorneys' fees has been described as the "prevailing party." Sometimes it will be unclear which party "prevailed," for example, where there are multiple issues and one party wins on some and the other party wins on others. Determining which is the prevailing party is in the discretion of the court. Subsection (e) authorizes attorney's fees in all actions where a remedy is sought "under this article." It applies even when the remedy might be an injunction under Section 5-109 or when the claimed remedy is otherwise outside of Section 5-111. Neither an issuer nor a confirmer should be treated as a "losing" party when an injunction is granted to the applicant over the objection of the issuer or confirmer; accordingly neither should be liable for fees and expenses in that case.

"Expenses of litigation" is intended to be broader than "costs." For example, expense of litigation would include travel expenses of witnesses, fees for expert witnesses, and expenses associated with taking depositions.

7. For the purposes of Section 5-111(f) "harm anticipated" must be anticipated at the time when the agreement that includes the liquidated damage clause is executed or at the time when the undertaking that includes the clause is issued. See Section 2A-504.

ANNOTATION

Annotator's note. Since § 4-5-111 is similar to § 4-5-115 as it existed prior to the 1996 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

For contractual relationships arising from letter of credit, see Dovenmuehle, Inc. v. East Bank, 38 Colo. App. 507, 563 P.2d 24 (1977), aff'd, 196 Colo. 422, 589 P.2d 1361 (1978).

Relevant nondocumentary conditions includable in letter of credit. The obligation of the issuer of a letter of credit to honor the letter is wholly separate from the beneficiary's compliance with the terms of the underlying contract and is dependent solely on the terms and conditions contained in the letter of credit. This disjunction between a letter of credit and the underlying obligation does not, however, prohibit including in the letter of credit itself nondoucmentary conditions which are relevant both to satisfaction of the terms of the underlying contract and of the letter of credit. Raiffeisen-Zentralkasse Tirol v. First Nat'l Bank, 671 P.2d 1008 (Colo. App. 1983).

Applied in Bd. of County Comm'rs v. Colo. Nat'l Bank, 43 Colo. App. 186, 607 P.2d 1010 (1979); General Ins. Co. of Am. v. City of Colo. Springs, 638 P.2d 752 (Colo. 1981).

4-5-112. Transfer of letter of credit. (a) Except as otherwise provided in section 4-5-113, unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.

(b) Even if a letter of credit provides that it is transferable, the issuer may refuse to recognize or carry out a transfer if:

(1) The transfer would violate applicable law; or

(2) The transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other requirement relating to transfer imposed by the issuer which is within the standard practice referred to in section 4-5-108 (e) or is otherwise reasonable under the circumstances.

Source: L. 96: Entire article R&RE, p. 198, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-116 as it existed prior to 1996.

OFFICIAL COMMENT

1. In order to protect the applicant's reliance on the designated beneficiary, letter of credit law traditionally has forbidden the beneficiary to convey to third parties its right to draw or demand payment under the letter of credit. Subsection (a) codifies that rule. The term "transfer" refers to the beneficiary's conveyance of that right. Absent incorporation of the UCP (which make elaborate provision for partial transfer of a commercial letter of credit) or similar trade practice and absent other express indication in the letter of credit that the term is used to mean something else, a term in the letter of credit indicating that the beneficiary has the right to transfer should be taken to mean that the beneficiary may convey to a third party its right to draw or demand payment. Even in that case, the issuer or other person controlling the transfer may make the beneficiary's right to transfer subject to conditions, such as timely notification, payment of a fee, delivery of the letter of credit to the issuer or other person controlling the transfer, or execution of appropriate forms to document the transfer. A nominated person who is not a confirmer has no obligation to recognize a transfer.

The power to establish "requirements" does not include the right absolutely to refuse to recognize transfers under a transferable letter of credit. An issuer who wishes to retain the right to deny all transfers should not issue transferable letters of credit or should incorporate the UCP. By stating its requirements in the letter of credit an issuer may impose any requirement without regard to its conformity to practice or reasonableness. Transfer requirements of issuers and nominated persons must be made known to potential transferors and transferees to enable those parties to comply with the requirements. A common method of making such requirements known is to use a form that indicates the information that must be provided and the instructions that must be given to enable the issuer or nominated person to comply with a request to transfer.

2. The issuance of a transferable letter of credit with the concurrence of the applicant is ipso facto an agreement by the issuer and applicant to permit a beneficiary to transfer its drawing right and permit a nominated person to recognize and carry out that transfer without further notice to them. In international com-

merce, transferable letters of credit are often issued under circumstances in which a nominated person or adviser is expected to facilitate the transfer from the original beneficiary to a transferee and to deal with that transferee. In those circumstances it is the responsibility of the nominated person or adviser to establish procedures satisfactory to protect itself against double presentation or dispute about the right to draw under the letter of credit. Commonly such a person will control the transfer by requiring that the original letter of credit be given to it or by causing a paper copy marked as an original to be issued where the original letter of credit was electronic. By keeping possession of the original letter of credit the nominated person or adviser can minimize or entirely exclude the possibility that the original beneficiary could properly procure payment from another bank. If the letter of credit requires presentation of the original letter of credit itself, no other payment could be procured. In addition to imposing whatever requirements it considers appropriate to protect itself against double payment the person that is facilitating the transfer has a right to charge an appropriate fee for its activity.

"Transfer" of a letter of credit should be distinguished from "assignment of proceeds." The former is analogous to a novation or a substitution of beneficiaries. It contemplates not merely payment to but also performance by the transferee. For example, under the typical terms of transfer for a commercial letter of credit, a transferee could comply with a letter of credit transferred to it by signing and presenting its own draft and invoice. An assignee of proceeds, on the other hand, is wholly dependent on the presentation of a draft and invoice signed by the beneficiary.

By agreeing to the issuance of a transferable letter of credit, which is not qualified or limited, the applicant may lose control over the identity of the person whose performance will earn payment under the letter of credit.

4-5-113. Transfer by operation of law. (a) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.

(b) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Except as otherwise provided in subsection (e) of this section, an issuer shall recognize a disclosed successor of a beneficiary as beneficiary in full substitution for its predecessor upon compliance with the requirements for recognition by the issuer of a transfer of drawing rights by operation of law under the standard practice referred to in section 4-5-108 (e) or, in the absence of such a practice, compliance with other reasonable procedures sufficient to protect the issuer.

(c) An issuer is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of a purported successor is genuine or authorized.

(d) Honor of a purported successor's apparently complying presentation under subsection (a) or (b) of this section has the consequences specified in section 4-5-108 (i) even if the purported successor is not the successor of a beneficiary. Documents signed in the name of the beneficiary or of a disclosed successor by a person who is neither the beneficiary nor the successor of the beneficiary are forged documents for the purposes of section 4-5-109.

(e) An issuer whose rights of reimbursement are not covered by subsection (d) of this section or substantially similar law and any confirmer or nominated person may decline to recognize a presentation under subsection (b) of this section.

(f) A beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of a beneficiary under this section.

Source: L. 96: Entire article R&RE, p. 198, § 1, effective July 1.

OFFICIAL COMMENT

This section affirms the result in Pastor v. Nat. Republic Bank of Chicago, 76 Ill.2d 139, 390 N.E.2d 894 (Ill. 1979) and Federal Deposit Insurance Co. v. Bank of Boulder, 911 F.2d 1466 (10th Cir. 1990).

An issuer's requirements for recognition of a successor's status might include presentation of a certificate of merger, a court order appointing a bankruptcy trustee or receiver, a certificate of appointment as bankruptcy trustee, or the like. The issuer is entitled to rely upon such documents which on their face demonstrate that presentation is made by a successor of a beneficiary. It is not obliged to make an independent investigation to determine the fact of succession.

4-5-114. Assignment of proceeds. (a) In this section, "proceeds of a letter of credit" means the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(b) A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(c) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

(d) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.

(e) Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

(f) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary, or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by article 9 of this title or other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by article 9 of this title or other law.

Source: L. 96: Entire article R&RE, p. 199, § 1, effective July 1.

Editor's note: This section is similar to former § 4-5-116 as it existed prior to 1996.

OFFICIAL COMMENT

1. Subsection (b) expressly validates the beneficiary's present assignment of letter of credit proceeds if made after the credit is established but before the proceeds are realized. This section adopts the prevailing usage — "assignment of proceeds" — to an assignee. That terminology carries with it no implication, however, that an assignee acquires no interest until the proceeds are paid by the issuer. For example, an "assignment of the right to proceeds" of a letter of credit for purposes of security that meets the requirements of Section 9-203(1) would constitute the present creation of a security interest in that right. This security interest can be perfected by possession (Section 9-305) if the letter of credit is in written form. Although subsection (a) explains the meaning of "'proceeds' of a letter of credit," it should be emphasized that those proceeds also may be Article 9 proceeds of other collateral. For example, if a seller of inventory receives a letter of credit to support the account that arises upon the sale, payments made under the letter of credit are Article 9 proceeds of the inventory, account, and any document of title covering the inventory. Thus, the secured party who had a perfected security interest in that inventory, account, or document has a perfected security interest in the proceeds collected under the letter of credit, so long as they are identifiable cash proceeds (Section 9-306(2), (3)). This perfection is continuous, regardless of whether the secured party perfected a security interest in the right to letter of credit proceeds.

2. An assignee's rights to enforce an assignment of proceeds against an issuer and the priority of the assignee's rights against a nominated person or transferee beneficiary are governed by Article 5. Those rights and that priority are stated in subsections (c), (d), and (e). Note also that Section 4-210 gives first priority to a collecting bank that has given value for a documentary draft.

3. By requiring that an issuer or nominated person consent to the assignment of proceeds of a letter of credit, subsections (c) and (d) follow more closely recognized national and international letter of credit practices than did prior law. In most circumstances, it has always been advisable for the assignee to obtain the consent of the issuer in order better to safeguard its right to the proceeds. When notice of an assignment has

been received, issuers normally have required signatures on a consent form. This practice is reflected in the revision. By unconditionally consenting to such an assignment, the issuer or nominated person becomes bound, subject to the rights of the superior parties specified in subsection (e), to pay to the assignee the assigned letter of credit proceeds that the issuer or nominated person would otherwise pay to the beneficiary or another assignee.

Where the letter of credit must be presented as a condition to honor and the assignee holds and exhibits the letter of credit to the issuer or nominated person, the risk to the issuer or nominated person of having to pay twice is minimized. In such a situation, subsection (d) provides that the issuer or nominated person may not unreasonably withhold its consent to the assignment.

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Contractual relationships arising from letter of credit. See Dovenmuehle, Inc. v. East Bank, 38 Colo. App. 507, 563 P.2d 24 (1977), aff'd, 196 Colo. 422, 589 P.2d 1361 (1978); Leney v. Plum Grove Bank, 670 F.2d 878 (10th Cir. 1982).

Strict compliance with terms of letter of credit is required to maintain the commercial vitality of the letter of credit device. Colo. Nat'l Bank v. Bd. of County Comm'rs, 634 P.2d 32 (Colo. 1981).

Independence of letters of credit to be preserved. The purpose of the letter of credit requires that the unique feature of the letter of credit, i.e., their independence from the contract between the customer and the beneficiary, be preserved by courts. Dovenmuehle, Inc. v. East Bank, 38 Colo. App. 507, 563 P.2d 24 (1977), aff'd, 196 Colo. 422, 589 P.2d 1361 (1978).

The transactions or contracts underlying the bank's issuance of a letter of credit have no bearing whatsoever on the bank's primary liability to the beneficiary of the letter. Bd. of County Comm'rs v. Colo. Nat'l Bank, 43 Colo. App. 186, 607 P.2d 1010 (1979), aff'd in part and rev'd in part on other grounds, 634 P.2d 32 (Colo. 1981).

Effect of letter of credit on issuing bank. By issuing a letter of credit, the bank substitutes its credit for that of its customer. Leney v. Plum Grove Bank, 670 F.2d 878 (10th Cir. 1982).

Letters of credit are actual liabilities of a bank. Bank acted properly in freezing accounts of beneficiary even though no demand for payment under letters of credit issued by bank had been made. Balzano v. United Bank of Denver, 761 P.2d 229 (Colo. App. 1988).

Letters of credit do not eradicate the contractual latitude afforded the parties, but are intended to enhance it. Dovenmuehle, Inc. v. East Bank, 38 Colo. App. 507, 563 P.2d 24 (1977), aff'd, 196 Colo. 422, 589 P.2d 1361 (1978).

Within broad limits, an issuer and the beneficiary may agree that various conditions be satisfied by documentation prior to payment. Dovenmuehle, Inc. v. East Bank, 38 Colo. App. 507, 563 P.2d 24 (1977), aff'd, 196 Colo. 422, 589 P.2d 1361 (1978).

And contract principles may be considered in deciding controversies. As a result of the flexibility with which the issuer and beneficiary may agree to conditions to payment, contract principles are not necessarily precluded from consideration in deciding controversies involving letters of credit if the parties embody them within the terms of the credit. Dovenmuehle, Inc. v. East Bank, 38 Colo. App. 507, 563 P.2d 24 (1977), aff'd, 196 Colo. 422, 589 P.2d 1361 (1978).

Issuer may pay on letter of credit despite notice of irregularity. The issuer of a letter of credit may, in good faith, honor a draft or demand for payment notwithstanding notice from its customer that documents are forged or fraudulent or that there is fraud in the transaction; the issuer may, however, be enjoined from honoring such drafts or demands for payment. Colo. Nat'l Bank v. Bd. of County Comm'rs, 634 P.2d 32 (Colo. 1981).

"Fraud in the transaction", as referred to in subsection (2), must stem from conduct by the beneficiary of the letter of credit as against the customer of the bank. Colo. Nat'l Bank v. Bd. of County Comm'rs, 634 P.2d 32 (Colo. 1981).

Fraud must be of such an egregious nature as to vitiate the entire underlying transaction so that the legitimate purposes of the independence of the bank's obligation would no longer be served. Colo. Nat'l Bank v. Bd. of County Comm'rs, 634 P.2d 32 (Colo. 1981).

When issuer confined to stated grounds for dishonor. An issuer is confined to its stated grounds for dishonor where the statements have misled the beneficiary who could have cured the defect but relied on the stated grounds to its injury. Colo. Nat'l Bank v. Bd. of County Comm'rs, 634 P.2d 32 (Colo. 1981).

Waiver of grounds for refusal to pay. In cases involving letters of credit, a refusal to pay by an issuer formally placed on one ground will be deemed a waiver of all others based on the letter of credit. Dovenmuehle, Inc. v. East Bank, 38 Colo. App. 507, 563 P.2d 24 (1977), aff'd, 196 Colo. 422, 589 P.2d 1361 (1978).

"Guaranty letter of credit" issued by a bank requiring a documentary demand, and conspicuously stating that it was a letter of credit, falls squarely within the definition of letter of credit, so that a defendant bank cannot escape its obligation to honor a demand on it. East Bank v. Dovenmuehle, Inc., 196 Colo. 422, 589 P.2d 1361 (1978).

Standby letters of credit, suretyship and guaranty contracts compared. Colo. Nat'l Bank v. Bd. of County Comm'rs, 634 P.2d 32 (Colo. 1981).

Surety contract not similar. An analogy between a surety contract and a letter of credit is not well taken. General Ins. Co. of Am. v. City of Colo. Springs, 638 P.2d 752 (Colo. 1981).

Forum for suing out-of-state issuing bank limited. It is unfair to burden an out-of-state issuing bank with having to defend litigation over a letter of credit in any state in which the bank could reasonably expect the credit to be used. Leney v. Plum Grove Bank, 670 F.2d 878 (10th Cir. 1982).

4-5-115. Statute of limitations. An action to enforce a right or obligation arising under this article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the cause of action accrues, whichever occurs later. A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

Source: L. 96: Entire article R&RE, p. 200, § 1, effective July 1.

OFFICIAL COMMENT

1. This section is based upon Sections 4-111 and 2-725(2).

2. This section applies to all claims for which there are remedies under Section 5-111 and to other claims made under this article, such as claims for breach of warranty under Section 5-110. Because it covers all claims under Section 5-111, the statute of limitations applies not only to wrongful dishonor claims against the issuer but also to claims between the issuer and the applicant arising from the reimbursement agreement. These might be for reimbursement (issuer v. applicant) or for breach of the reimbursement contract by wrongful honor (applicant v. issuer).

3. The statute of limitations, like the rest of the statute, applies only to a letter of credit issued on or after the effective date and only to transactions, events, obligations, or duties arising out of or associated with such a letter. If a letter of credit was issued before the effective date and an obligation on that letter of credit was breached after the effective date, the complaining party could bring its suit within the time that would have been permitted prior to the adoption of Section 5-115 and would not be limited by the terms of Section 5-115.

4-5-116. Choice of law and forum. (a) The liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in section 4-5-104 or by a provision in the person's letter of credit, confirmation, or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the transaction.

(b) Unless subsection (a) of this section applies, the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. The person is considered to be located at the address indicated in the person's undertaking. If more than one address is indicated, the person is considered to be located at the address from which the person's undertaking was issued. For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate juridical entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection (b).

(c) Except as otherwise provided in this subsection (c), the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the "Uniform Customs and Practice for Documentary Credits", to which the letter of credit, confirmation, or other undertaking is expressly made subject. If (i) this article would govern the liability of an issuer, nominated person, or adviser under subsection (a) or (b) of this

section, (ii) the relevant undertaking incorporates rules of custom or practice, and (iii) there is conflict between this article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in section 4-5-103 (c).

(d) If there is conflict between this article and article 3, 4, 4.5, or 9 of this title, this article governs.

(e) The forum for settling disputes arising out of an undertaking within this article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with subsection (a) of this section.

Source: L. 96: Entire article R&RE, p. 200, § 1, effective July 1.

OFFICIAL COMMENT

1. Although it would be possible for the parties to agree otherwise, the law normally chosen by agreement under subsection (a) and that provided in the absence of agreement under subsection (b) is the substantive law of a particular jurisdiction not including the choice of law principles of that jurisdiction. Thus, two parties, an issuer and an applicant, both located in Oklahoma might choose the law of New York. Unless they agree otherwise, the section anticipates that they wish the substantive law of New York to apply to their transaction and they do not intend that a New York choice of law principle might direct a court to Oklahoma law. By the same token, the liability of an issuer located in New York is governed by New York substantive law — in the absence of agreement — even in circumstances in which choice of law principles found in the common law of New York might direct one to the law of another State. Subsection (b) states the relevant choice of law principles and it should not be subordinated to some other choice of law rule. Within the States of the United States renvoi will not be a problem once every jurisdiction has enacted Section 5-116 because every jurisdiction will then have the same choice of law rule and in a particular case all choice of law rules will point to the same substantive law.

Subsection (b) does not state a choice of law rule for the "liability of an applicant." However, subsection (b) does state a choice of law rule for the liability of an issuer, nominated person, or adviser, and since some of the issues in suits by applicants against those persons involve the "liability of an issuer, nominated person, or adviser," subsection (b) states the choice of law rule for those issues. Because an issuer may have liability to a confirmer both as an issuer (Section 5-108(a), Comment 5 to Section 5-108) and as an applicant (Section 5-107(a), Comment 1 to Section 5-107, Section 5-108(i)), subsection (b) may state the choice of law rule for some but not all of the issuer's liability in a suit by a confirmer.

2. Because the confirmer or other nominated person may choose different law from that chosen by the issuer or may be located in a different jurisdiction and fail to choose law, it is possible that a confirmer or nominated person may be obligated to pay (under their law) but will not be entitled to payment from the issuer (under its law). Similarly, the rights of an unreimbursed issuer, confirmer, or nominated person against a beneficiary under Section 5-109, 5-110, or 5-117, will not necessarily be governed by the same law that applies to the issuer's or confirmer's obligation upon presentation. Because the UCP and other practice are incorporated in most international letters of credit, disputes arising from different legal obligations to honor have not been frequent. Since Section 5-108 incorporates standard practice, these problems should be further minimized — at least to the extent that the same practice is and continues to be widely followed.

3. This section does not permit what is now authorized by the nonuniform Section 5-102(4) in New York. Under the current law in New York a letter of credit that incorporates the UCP is not governed in any respect by Article 5. Under revised Section 5-116 letters of credit that incorporate the UCP or similar practice will still be subject to Article 5 in certain respects. First, incorporation of the UCP or other practice does not override the nonvariable terms of Article 5. Second, where there is no conflict between Article 5 and the relevant provision of the UCP or other practice, both apply. Third, practice provisions incorporated in a letter of credit will not be effective if they fail to comply with Section 5-103(c). Assume, for example, that a practice provision purported to free a party from any liability unless it were "grossly negligent" or that the practice generally limited the remedies that one party might have against another. Depending upon the circumstances, that disclaimer or limitation of liability might be ineffective because of Section 5-103(c).

Even though Article 5 is generally consistent with UCP 500, it is not necessarily consistent with other rules or with versions of the UCP that may be adopted after Article 5's revision, or with other practices that may develop. Rules of

practice incorporated in the letter of credit or other undertaking are those in effect when the letter of credit or other undertaking is issued. Except in the unusual cases discussed in the immediately preceding paragraph, practice adopted in a letter of credit will override the rules of Article 5 and the parties to letter of credit transactions must be familiar with practice (such as future versions of the UCP) that is explicitly adopted in letters of credit.

4. In several ways Article 5 conflicts with and overrides similar matters governed by Articles 3 and 4. For example, "draft" is more broadly defined in letter of credit practice than under Section 3-104. The time allowed for honor and the required notification of reasons for dishonor are different in letter of credit practice than in the handling of documentary and other drafts under Articles 3 and 4.

5. Subsection (e) must be read in conjunction with existing law governing subject matter jurisdiction. If the local law restricts a court to certain subject matter jurisdiction not including letter of credit disputes, subsection (e) does not authorize parties to choose that forum. For example, the parties' agreement under Section 5-116(e) would not confer jurisdiction on a probate court to decide a letter of credit case.

If the parties choose a forum under subsection (e) and if — because of other law — that forum will not take jurisdiction, the parties' agreement or undertaking should then be construed (for the purpose of forum selection) as though it did not contain a clause choosing a particular forum. That result is necessary to avoid sentencing the parties to eternal purgatory where neither the chosen State nor the State which would have jurisdiction but for the clause will take jurisdiction — the former in disregard of the clause and the latter in honor of the clause.

4-5-117. Subrogation of issuer, applicant, and nominated person. (a) An issuer that honors a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(b) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter, or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in subsection (a) of this section.

(c) A nominated person who pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of:

(1) The issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant;

(2) The beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

(3) The applicant to same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(d) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (a) and (b) of this section do not arise until the issuer honors the letter of credit or otherwise pays and the rights in subsection (c) of this section do not arise until the nominated person pays or otherwise gives value. Until then, the issuer, nominated person, and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense, or excuse.

Source: L. 96: Entire article R&RE, p. 201, § 1, effective July 1.

OFFICIAL COMMENT

1. By itself this section does not grant any right of subrogation. It grants only the right that would exist if the person seeking subrogation "were a secondary obligor." (The term "secondary obligor" refers to a surety, guarantor, or other person against whom or whose property an obligee has recourse with respect to the obligation of a third party. See Restatement of the Law Third, Suretyship § 1 (1995)). If the secondary obligor would not have a right to subrogation in the circumstances in which one is claimed under this section, none is granted by this section. In effect, the section does no more than to remove an impediment that some courts have found to subrogation because they conclude that the issuer's or other claimant's rights are "independent" of the underlying obligation. If, for example, a secondary obligor would not have a

subrogation right because its payment did not fully satisfy the underlying obligation, none would be available under this section. The section indorses the position of Judge Becker in Tudor Development Group, Inc. v. United States Fidelity and Guaranty, 968 F.2d 357 (3rd Cir. 1991).

2. To preserve the independence of the letter of credit obligation and to insure that subrogation not be used as an offensive weapon by an issuer or others, the admonition in subsection (d) must be carefully observed. Only one who has completed its performance in a letter of credit transaction can have a right to subrogation. For example, an issuer may not dishonor and then defend its dishonor or assert a setoff on the ground that it is subrogated to another person's rights. Nor may the issuer complain after honor that its subrogation rights have been impaired by any good faith dealings between the beneficiary and the applicant or any other person. Assume, for example, that the beneficiary under a standby letter of credit is a mortgagee. If the mortgagee were obliged to issue a release of the mortgage upon payment of the underlying debt (by the issuer under the letter of credit), that release might impair the issuer's rights of subrogation, but the beneficiary would have no liability to the issuer for having granted that release.

4-5-117.5. Security interest of issuer or nominated person. (a) An issuer or nominated person has a security interest in a document presented under a letter of credit to the extent that the issuer or nominated person honors or gives value for the presentation.

(b) So long as and to the extent that an issuer or nominated person has not been reimbursed or has not otherwise recovered the value given with respect to a security interest in a document under subsection (a) of this section, the security interest continues and is subject to article 9 of this title, but:

(1) A security agreement is not necessary to make the security interest enforceable under section 4-9-203 (b) (3);

(2) If the document is presented in a medium other than a written or other tangible medium, the security interest is perfected; and

(3) If the document is presented in a written or other tangible medium and is not a certificated security, chattel paper, a document of title, an instrument, or a letter of credit, the security interest is perfected and has priority over a conflicting security interest in the document so long as the debtor does not have possession of the document.

Source: L. 2001: Entire section added, p. 1441, § 28, effective July 1.

4-5-118. Applicability. This article applies to a letter of credit that is issued on or after July 1, 1996. This article does not apply to a transaction, event, obligation, or duty arising out of or associated with a letter of credit that was issued before July 1, 1996.

Source: L. 96: Entire article R&RE, p. 202, § 1, effective July 1.

4-5-119. Savings clause. A transaction arising out of or associated with a letter of credit that was issued before July 1, 1996, and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed when this article was enacted as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.

Source: L. 96: Entire article R&RE, p. 202, § 1, effective July 1.

ARTICLE 6

Bulk Transfers

Editor's note: (1) The repeal of this article was recommended by the National Conference of Commissioners on Uniform State Laws and the American Law Institute. The rationale for the repeal is set out in a "Prefatory Note" provided by the Conference and the Institute. That note is reprinted following this Editor's Note.

(2) Colorado has adopted the acts referred to in the "Prefatory Note". The "Uniform Enforcement of Foreign Judgments Act" is article 53 of title 13, C.R.S., and the "Uniform Fraudulent Transfer Act" is article 8 of title 38, C.R.S.

(3) This article was numbered as article 6 of chapter 155, C.R.S. 1963. For amendments to this article prior to its repeal in 1991, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

PREFATORY NOTE

Background. Bulk sale legislation originally was enacted in response to a fraud perceived to be common around the turn of the century: a merchant would acquire his stock in trade on credit, then sell his entire inventory ("in bulk") and abscond with the proceeds, leaving creditors unpaid. The creditors had a right to sue the merchant on the unpaid debts, but that right often was of little practical value. Even if the merchant-debtor was found, in personam jurisdiction over him might not have been readily available. Those creditors who succeed in obtaining a judgment often were unable to satisfy it because the defrauding seller had spent or hidden the sale proceeds. Nor did the creditors ordinarily have recourse to the merchandise sold. The transfer of the inventory to an innocent buyer effectively immunized the goods from the reach of the seller's creditors. The creditors of a bulk seller thus might be left without a means to satisfy their claims.

To a limited extent, the law of fraudulent conveyances ameliorated the creditors' plight. When the buyer in bulk was in league with the seller or paid less than full value for the inventory, fraudulent conveyance law enabled the defrauded creditors to avoid the sale and apply the transferred inventory toward the satisfaction of their claims against the seller. But fraudulent conveyance law provided no remedy against persons who bought in good faith, without reason to know of the seller's intention to pocket the proceeds and disappear, and for adequate value. In those cases, the only remedy for the seller's creditors was to attempt to recover from the absconding seller.

State legislatures responded to this perceived "bulk sale risk" with a variety of legislative enactments. Common to these statutes was the imposition of a duty on the buyer in bulk to notify the seller's creditors of the impending sale. The buyer's failure to comply with these and any other statutory duties generally afforded the seller's creditors a remedy analogous to the remedy for fraudulent conveyances: the creditors acquired the right to set aside the sale and reach the transferred inventory in the hands of the buyer.

Like its predecessors, Article 6 (1987 Official Text) is remarkable in that it obligates buyers in bulk to incur costs to protect the interests of the seller's creditors, with whom they usually have no relationship. Even more striking is that Article 6 affords creditors a remedy against a good faith purchaser for full value without notice of any wrongdoing on the part of the seller. The Article thereby impedes normal business transactions, many of which can be expected to benefit the seller's creditors. For this reason, Article 6 has been subjected to serious criticism. See, e.g., Rapson, U.C.C. Article 6: Should It Be Revised or "Deep-Sixed"? 38 Bus. Law. 1753 (1983).

In the legal context in which Article 6 (1987 Official Text) and its nonuniform predecessors were enacted, the benefits to creditors appeared to justify the costs of interfering with good faith transactions. Today, however, creditors are better able than ever to make informed decisions about whether to extend credit. Changes in technology have enabled credit reporting services to provide fast, accurate, and more complete credit histories at relatively little cost. A search of the public real estate and personal property records will disclose most encumbrances on a debtor's property with little inconvenience.

In addition, changes in the law now afford creditors greater opportunities to collect their debts. The development of "minimum contacts" with the forum state as a basis for in personam jurisdiction and the universal promulgation of state long-arm statutes and rules have greatly improved the possibility of obtaining personal jurisdiction over a debtor who flees to another state. Widespread enactment of the Uniform Enforcement of Foreign Judgments Act has facilitated nationwide collection of judgments. And to the extent that a bulk sale is fraudulent and the buyer is a party to fraud, aggrieved creditors have a remedy under the Uniform Fraudulent Transfer Act. Moreover, creditors of a merchant no longer face the choice of extending unsecured credit or no credit at all. Retaining an interest in inventory to secure its price has become relatively simple and inexpensive under Article 9.

Finally, there is no evidence that, in today's economy, fraudulent bulk sales are frequent enough, or engender credit losses significant enough, to require regulation of all bulk sales, including the vast majority that are conducted in good faith. Indeed, the experience of the Canadian Province of British Columbia, which repealed its Sale of Goods in Bulk Act in 1985, and of the United Kingdom, which never has enacted bulk sales legislation, suggests that regulation of bulk sales no longer is necessary.

Recommendation. The National Conference of Commissioners on Uniform State Laws and the American Law Institute believe that changes

in the business and legal contexts in which sales are conducted have made regulation of bulk sales unnecessary. The Conference and the Institute therefore withdraw their support for Article 6 of the Uniform Commercial Code and encourage those states that have enacted the Article to repeal it.

The Conference and the Institute recognize that bulk sales may present a particular problem in some states and that some legislatures may wish to continue to regulate bulk sales. They believe that existing Article 6 has become inadequate for that purpose. For those states that are disinclined to repeal Article 6, they have promulgated a revised version of Article 6. The revised Article is designed to afford better protection to creditors while minimizing the impediments to good-faith transactions.

The Official Comment to Section 6-101 explains the rationale underlying the revisions and highlights the major substantive changes reflected in them. Of particular interest is Section 6-103(1)(a), which limits the application of the revised Article to bulk sales by sellers whose principal business is the sale of inventory from stock. In approving this provision, the Conference and the Institute were mindful that some states have expanded the coverage of existing Article 6 to include bulk sales conducted by sellers whose principal business is the operation of a restaurant or tavern. Expansion of the scope of revised Article 6 is inconsistent with the recommendation that Article 6 be repealed. Nevertheless, the inclusion of restaurants and taverns within the scope of the revised Article as it is enacted in particular jurisdictions would not disturb the internal logic and structure of the revised Article.

4-6-101 to 4-6-111. (Repealed)

Source: L. 91: Entire article repealed, p. 269, § 1, effective July 1.

4-6-112. Savings clause. (Repealed)

Source: L. 91: Entire section repealed, p. 269, § 2, effective July 1, 1992.

ARTICLE 7

Documents of Title

Editor's note: (1) The "Uniform Commercial Code-Documents of Title", as adopted by the Colorado General Assembly in 2006, reflects the draft version of the Code and the Comments thereto by the National Conference of Commissioners on Uniform State Laws and American Law Institute dated February 2003.

(2) This article was numbered as article 7 of chapter 155, C.R.S. 1963. The provisions of this article were repealed and reenacted in 2006, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 2006, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated.

Law reviews: For article, "Documents of Title", see 11 Colo. Law. 1150 (1982).

PREFATORY NOTE

Article 7 is the last of the articles of the Uniform Commercial Code to be revised during the preceding decade. The genesis of this project is twofold: to provide a framework for the further development of electronic documents of title and to update the article for modern times in light of state, federal and international developments. Each section has been reviewed to determine its suitability given modern practice, the need for medium and gender neutrality, and modern statutory drafting.

To provide for electronic documents of title, several definitions in Article 1 were revised including "bearer," "bill of lading," "delivery," "document of title," "holder," and "warehouse receipt." The concept of an electronic document of title was to allow for commercial practice to determine what records issued by

bailees are "in the regular course of business or financing" are "treated as adequately evidencing that the person in possession or control of the record is entitled to receive, control, hold, and dispose of the record and the goods the record covers." Rev. Section 1-201(b)(16). Such records in electronic form are electronic documents of title and in tangible form are tangible documents of title. Conforming amendments to other Articles of the UCC are also necessary to fully integrate electronic documents of title into the UCC. Conforming amendments to other Articles of the UCC are contained in Appendix I and conforming amendments to other uniform acts are contained in Appendix II.

Key to the integration of the electronic document of title scheme is the concept of "control" defined in Section 7-106. This definition is adapted from the Uniform Electronic Transactions Act 16 on Transferrable Records and from Uniform Commercial Code 9-105 concerning control of electronic chattel paper. Control of an electronic document of title is the conceptual equivalent to possession and indorsement of a tangible document of title. Of equal importance is the acknowledgment that parties may desire to substitute an electronic document of title for an already- issued paper document and vice versa. Section 7-105 sets forth the minimum requirements that need to be fulfilled in order to give effect to the converted document. To the extent possible, the rules for electronic documents of title are the same or as similar as possible to the rules for tangible documents of title. If a rule is meant to be limited to one medium or the other, that is clearly stated. Rules that reference documents of title, warehouse receipts, or bills of lading without a designation to "electronic" or "tangible" apply to documents of title in either medium. As with tangible negotiable documents of title, electronic negotiable documents of title may be negotiated and duly negotiated. Section 7-501.

Other changes that have been made are:

1. New definitions of "carrier," "good faith," "record", "sign" and "shipper" in Section 7-102.
2. Deletion of references to tariffs or filed classifications given the deregulation of the affected industries. See e.g. section 7-103 and 7-309,
3. Clarifying the rules regarding when a document is nonnegotiable. Section 7-104.
4. Making clear when rules apply just to warehouse receipts or bills of lading, thus eliminating the need for former section 7-105.
5. Clarifying that particular terms need not be included in order to have a valid warehouse receipt. Section 7-202.
6. Broadening the ability of the warehouse to make an effective limitation of liability in its warehouse receipt or storage agreement in accord with commercial practice. Section 7-204.
7. Allowing a warehouse to have a lien on goods covered by a storage agreement and clarifying the priority rules regarding the claim of a warehouse lien as against other interests. Section 7-209.
8. Conforming language usage to modern shipping practice. Sections 7-301 and 7-302.
9. Clarifying the extent of the carrier's lien. Section 7-307.
10. Adding references to Article 2A when appropriate. See e.g. Sections 7-503, 7-504, 7-509.
11. Clarifying that the warranty made by negotiation or delivery of a document of title should apply only in the case of a voluntary transfer of possession or control. Section 7-507.
12. Providing greater flexibility to a court regarding adequate protection against loss when ordering delivery of the goods or issuance of a substitute document. Section 7-601.
13. Providing conforming amendments to the other Articles of the Uniform Commercial Code to accommodate electronic documents of title.

PART 1

GENERAL

4-7-101. Short title. This article shall be known and may be cited as the "Uniform Commercial Code - Documents of Title".

Source: L. 2006: Entire article R&RE, p. 469, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-101 as it existed prior to 2006.

OFFICIAL COMMENT

This Article is a revision of the 1962 Official Text with Comments as amended since 1962. The 1962 Official Text was a consolidation and revision of the Uniform Warehouse Receipts Act

and the Uniform Bills of Lading Act, and embraced the provisions of the Uniform Sales Act relating to negotiation of documents of title.

This Article does not contain the substantive criminal provisions found in the Uniform Warehouse Receipts and Bills of Lading Acts. These criminal provisions are inappropriate to a Commercial Code, and for the most part duplicate portions of the ordinary criminal law relating to frauds. This revision deletes the former Section 7-105 that provided that courts could apply a rule from Parts 2 and 3 by analogy to a situation not explicitly covered in the provisions on warehouse receipts or bills of lading when it was appropriate. This is, of course, an unexceptional proposition and need not be stated explicitly in the statute. Thus former Section 7-105 has been deleted. Whether applying a rule by analogy to a situation is appropriate depends upon the facts of each case.

The Article does not attempt to define the tort liability of bailees, except to hold certain classes of bailees to a minimum standard of reasonable care. For important classes of bailees, liabilities in case of loss, damages or destruction, as well as other legal questions associated with particular documents of title, are governed by federal statutes, international treaties, and in some cases regulatory state laws, which supersede the provisions of this Article in case of inconsistency. See Section 7-103.

ANNOTATION

Law reviews. For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965).

4-7-102. Definitions and index of definitions. (a) In this article, unless the context otherwise requires:

(1) "Bailee" means a person that by a warehouse receipt, bill of lading, or other document of title acknowledges possession of goods and contracts to deliver them.

(2) "Carrier" means a person that issues a bill of lading.

(3) "Consignee" means a person named in a bill of lading to which or to whose order the bill promises delivery.

(4) "Consignor" means a person named in a bill of lading as the person from which the goods have been received for shipment.

(5) "Delivery order" means a record that contains an order to deliver goods directed to a warehouse, carrier, or other person that in the ordinary course of business issues warehouse receipts or bills of lading.

(6) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(7) "Goods" means all things that are treated as movable for the purposes of a contract for storage or transportation.

(8) "Issuer" means a bailee that issues a document of title or, in the case of an unaccepted delivery order, the person that orders the possessor of goods to deliver. The term includes a person for which an agent or employee purports to act in issuing a document if the agent or employee has real or apparent authority to issue documents, even if the issuer did not receive any goods, the goods were misdescribed, or in any other respect the agent or employee violated the issuer's instructions.

(9) "Person entitled under the document" means the holder, in the case of a negotiable document of title, or the person to which delivery of the goods is to be made by the terms of, or pursuant to instructions in a record under, a nonnegotiable document of title.

(10) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(11) "Shipper" means a person that enters into a contract of transportation with a carrier.

(12) "Sign" means, with present intent to authenticate or adopt a record:

(A) To execute or adopt a tangible symbol; or

(B) To attach to or logically associate with the record an electronic sound, symbol, or process.

(13) "Warehouse" means a person engaged in the business of storing goods for hire.

(b) Definitions in other articles applying to this article and the sections in which they appear are:

(1) "Contract for sale", section 4-2-106;
(2) "Lessee in the ordinary course of business", section 4-2.5-103;
(3) "'Receipt' of goods", section 4-2-103.

(c) In addition, article 1 of this title contains general definitions and principles of construction and interpretation applicable throughout this article.

Source: L. 2006: Entire article R&RE, p. 469, § 2, effective September 1. **L. 2007:** (b)(2) amended, p. 365, § 1, effective August 3.

Editor's note: This section is similar to former § 4-7-102 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-102.

Changes: New definitions of "carrier," "good faith," "record," "sign," and "shipper." Other definitions revised to accommodate electronic mediums.

Purposes:

1. "Bailee" is used in this Article as a blanket term to designate carriers, warehousemen and others who normally issue documents of title on the basis of goods which they have received. The definition does not, however, require actual possession of the goods. If a bailee acknowledges possession when it does not have possession, the bailee is bound by sections of this Article which declare the "bailee's" obligations. (See definition of "Issuer" in this section and Sections 7-203 and 7-301 on liability in case of non-receipt.) A "carrier" is one type of bailee and is defined as a person that issues a bill of lading. A "shipper" is a person who enters into the contract of transportation with the carrier. The definitions of "bailee," "consignee," "consignor," "goods", and "issuer", are unchanged in substance from prior law. "Document of title" is defined in Article 1 and may be either tangible or electronic form.

2. The definition of warehouse receipt contained in the general definitions section of this Act (Section 1-201) does not require that the issuing warehouse be "lawfully engaged" in business or for profit. The warehouse's compliance with applicable state regulations such as the filing of a bond has no bearing on the substantive issues dealt with in this Article. Certainly the issuer's violations of law should not diminish its responsibility on documents the issuer has put in commercial circulation. But it is still essential that the business be storing goods "for hire" (Section 1-201 and this section). A person does not become a warehouse by storing its own goods.

3. When a delivery order has been accepted by the bailee it is for practical purposes indistinguishable from a warehouse receipt. Prior to such acceptance there is no basis for imposing obligations on the bailee other than the ordinary obligation of contract which the bailee may have assumed to the depositor of the goods. Delivery orders may be either electronic or tangible documents of title. See definition of "document of title" in Section 1-201.

4. The obligation of good faith imposed by this Article and by Article 1, Section1- 304 includes the observance of reasonable commercial standards of fair dealing.

5. The definitions of "record" and "sign" are included to facilitate electronic mediums. See comment 9 to Section 9-102 discussing "record" and the comment to amended Section 2-103 discussing "sign."

6. "Person entitled under the document" is moved from former Section 7-403.

7. These definitions apply in this Article unless the context otherwise requires. The "context" is intended to refer to the context in which the defined term is used in the Uniform Commercial Code. The definition applies whenever the defined term is used unless the context in which the defined term is used in the statute indicates that the term was not used in its defined sense. See comment to Section 1-201.

Cross References:

Point 1: Sections 1-201, 7-203 and 7-301.
Point 2: Sections 1-201 and 7-203.
Point 3: Section 1-201.
Point 4: Section 1-304.
Point 5: Section 9-102 and 2-103.

See general comment to document of title in Section 1-201.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Contract". Section 1-201.
"Contract for sale". Section 2-106.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Person". Section 1-201.
"Purchase". Section 1-201.
"Receipt of goods". Section 2-103.
"Right". Section 1-201.
"Warehouse receipt". Section 1-201.

ANNOTATION

Drafts to bailee held nonnegotiable documents of title. While a bean company's drafts to a bailee were negotiable instruments, by subsection (1)(a) they were nonnegotiable documents of title since their terms did not require delivery of the beans to "bearer or to the order of a named person". Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976) (decided prior to the 2006 repeal and reenactment).

4-7-103. Relation of article to treaty or statute. (a) This article is subject to any treaty or statute of the United States or regulatory statute of this state to the extent the treaty, statute, or regulatory statute is applicable.

(b) This article does not modify or repeal any law prescribing the form or content of a document of title or the services or facilities to be afforded by a bailee, or otherwise regulating a bailee's business in respects not specifically treated in this article. However, violation of such a law does not affect the status of a document of title that otherwise is within the definition of a document of title.

(c) This article modifies, limits, and supersedes the federal "Electronic Signatures in Global and National Commerce Act", 15 U.S.C. sec. 7001 et seq., but does not modify, limit, or supersede section 101 (c) of that act, 15 U.S.C. sec. 7001 (c), or authorize electronic delivery of any of the notices described in section 103 (b) of that act, 15 U.S.C. sec. 7003 (b).

(d) To the extent there is a conflict between the "Uniform Electronic Transactions Act", article 71.3 of title 24, C.R.S., and this article, this article governs.

Source: L. 2006: Entire article R&RE, p. 470, § 2, effective September 1. **L. 2007:** Entire section amended, p. 365, § 2, effective August 3.

Editor's note: This section is similar to former § 4-7-103 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Sections 7-103 and 10-104.

Changes: Deletion of references to tariffs and classifications; incorporation of former Section 10-104 into subsection (b), provide for intersection with federal and state law governing electronic transactions.

Purposes:

1. To make clear what would of course be true without the Section, that applicable Federal law is paramount.

2. To make clear also that regulatory state statutes (such as those fixing or authorizing a commission to fix rates and prescribe services, authorizing different charges for goods of different values, and limiting liability for loss to the declared value on which the charge was based) are not affected by the Article and are controlling on the matters which they cover unless preempted by federal law. The reference in former Section 7-103 to tariffs, classifications, and regulations filed or issued pursuant to regulatory state statutes has been deleted as inappropriate in the modern era of diminished regulation of carriers and warehouses. If a regulatory scheme requires a carrier or warehouse to issue a tariff or classification, that tariff or classification would be given effect via the state regulatory scheme that this Article recognizes as controlling. Permissive tariffs or classifications would not displace the provisions of this act, pursuant to this section, but may be given effect through the ability of parties to incorporate those terms by reference into their agreement.

3. The document of title provisions of this act supplement the federal law and regulatory state law governing bailees. This Article focuses on the commercial importance and usage of documents of title. State ex. rel Public Service Commission v. Gunkelman & Sons, Inc., 219 N.W.2d 853 (N.D. 1974).

4. Subsection (c) is included to make clear the interrelationship between the federal Electronic Signatures in Global and National Commerce Act and this article and the conforming amendments to other articles of the Uniform Commercial Code promulgated as part of the revision of this article. Section 102 of the federal act allows a State statute to modify, limit, or supercede the provisions of Section 101 of the federal act. See the comments to Revised Article 1, Section 1-108.

5. Subsection (d) makes clear that once this article is in effect, its provisions regarding elec-

tronic commerce and regarding electronic documents of title control in the event there is a conflict with the provisions of the Uniform Electronic Transactions Act or other applicable state law governing electronic transactions.

Cross References:
Sections 1-108, 7-201, 7-202, 7-204, 7-206, 7-309, 7-401, 7-403.
Definitional Cross Reference:
"Bill of lading". Section 1-201.

ANNOTATION

Applied in Rio Grande Motor Way v. Resort Graphics, 740 P.2d 517 (Colo. 1987) (decided prior to the 2006 repeal and reenactment).

4-7-104. Negotiable and nonnegotiable document of title. (a) Except as otherwise provided in subsection (c) of this section, a document of title is negotiable if by its terms the goods are to be delivered to the bearer or to the order of a named person.

(b) A document of title other than one described in subsection (a) of this section, is nonnegotiable. A bill of lading that states that the goods are consigned to a named person is not made negotiable by a provision that the goods are to be delivered only against an order in a record signed by the same or another named person.

(c) A document of title is nonnegotiable if, at the time it is issued, the document has a conspicuous legend, however expressed, that it is nonnegotiable.

Source: L. 2006: Entire article R&RE, p. 471, § 2, effective September 1. **L. 2007:** (a) amended, p. 366, § 3, effective August 3.

Editor's note: This section is similar to former § 4-7-104 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-104.
Changes: Subsection (a) is revised to reflect modern style and trade practice. Subsection (b) is revised for style and medium neutrality. Subsection (c) is new.
Purposes:
1. This Article deals with a class of commercial paper representing commodities in storage or transportation. This "commodity paper" is to be distinguished from what might be called "money paper" dealt with in the Article of this Act on Commercial Paper (Article 3) and "investment paper" dealt with in the Article of this Act on Investment Securities (Article 8). The class of "commodity paper" is designated "document of title" following the terminology of the Uniform Sales Act Section 76. Section 1-201. The distinctions between negotiable and nonnegotiable documents in this section makes the most important subclassification employed in the Article, in that the holder of negotiable documents may acquire more rights than its transferor had (See Section 7-502). The former Section 7-104, which provided that a document of title was negotiable if it runs to a named person or assigns if such designation was recognized in overseas trade, has been deleted as not necessary in light of current commercial practice.

A document of title is negotiable only if it satisfies this section. "Deliverable on proper indorsement and surrender of this receipt" will not render a document negotiable. Bailees often include such provisions as a means of insuring return of nonnegotiable receipts for record purposes. Such language may be regarded as insistence by the bailee upon a particular kind of receipt in connection with delivery of the goods. Subsection (a) makes it clear that a document is not negotiable which provides for delivery to order or bearer only if written instructions to that effect are given by a named person. Either tangible or electronic documents of title may be negotiable if the document meets the requirement of this section.

2. Subsection (c) is derived from Section 3-104(d). Prior to issuance of the document of title, an issuer may stamp or otherwise provide by a notation on the document that it is nonnegotiable even if the document would otherwise comply with the requirement of subsection (a). Once issued as a negotiable document of title, the document cannot be changed from a negotiable document to a nonnegotiable document. A document of title that is nonnegotiable cannot be made negotiable by stamping or providing a notation that the document is negotiable. The only way to make a document of title negotiable is to comply with subsection (a). A negotiable document of title may fail to be duly negotiated if the negotiation does not comply with the requirements for "due negotiation" stated in Section 7-501.

Cross Reference:
Section 7-501 and 7-502.
Definitional Cross References:
"Bearer". Section 1-201.
"Bill of lading". Section 1-201.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Person". Section 1-201.
"Sign". Section 7-102.
"Warehouse receipt". Section 1-201.

ANNOTATION

Annotator's note. Since § 4-7-104 is similar to § 4-7-104 as it existed prior to the 2006 repeal and reenactment of this article, a relevant case construing that provision has been included in the annotations to this section.

Drafts to bailee held nonnegotiable documents of title. While a bean company's drafts to a bailee were negotiable instruments, by subsection (1)(a) they were nonnegotiable documents of title since their terms did not require delivery of the beans to "bearer or to the order of a named person". Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976).

4-7-105. Reissuance in alternative medium. (a) Upon request of a person entitled under an electronic document of title, the issuer of the electronic document may issue a tangible document of title as a substitute for the electronic document if:

(1) The person entitled under the electronic document surrenders control of the document to the issuer; and

(2) The tangible document when issued contains a statement that it is issued in substitution for the electronic document.

(b) Upon issuance of a tangible document of title in substitution for an electronic document of title in accordance with subsection (a) of this section:

(1) The electronic document ceases to have any effect or validity; and

(2) The person that procured issuance of the tangible document warrants to all subsequent persons entitled under the tangible document that the warrantor was a person entitled under the electronic document when the warrantor surrendered control of the electronic document to the issuer.

(c) Upon request of a person entitled under a tangible document of title, the issuer of the tangible document may issue an electronic document of title as a substitute for the tangible document if:

(1) The person entitled under the tangible document surrenders possession of the document to the issuer; and

(2) The electronic document when issued contains a statement that it is issued in substitution for the tangible document.

(d) Upon issuance of an electronic document of title in substitution for a tangible document of title in accordance with subsection (c) of this section:

(1) The tangible document ceases to have any effect or validity; and

(2) The person that procured issuance of the electronic document warrants to all subsequent persons entitled under the electronic document that the warrantor was a person entitled under the tangible document when the warrantor surrendered possession of the tangible document to the issuer.

Source: L. 2006: Entire article R&RE, p. 471, § 2, effective September 1. **L. 2007:** IP(d) amended, p. 366, § 4, effective August 3.

OFFICIAL COMMENT

Prior Uniform Statutory Provisions: None.
Other relevant law: UNCITRAL Draft Instrument on the Carriage of Goods by Sea Transport Law.
Purpose:

1. This section allows for documents of title issued in one medium to be reissued in another medium. This section applies to both negotiable and nonnegotiable documents. This section sets forth minimum requirements for giving the reissued document effect and validity. The issuer is not required to issue a document in an alternative medium and if the issuer chooses to do so, it may impose additional requirements. Because a document of title imposes obligations on the issuer of the document, it is imperative for

the issuer to be the one who issues the substitute document in order for the substitute document to be effective and valid.

2. The request must be made to the issuer by the person entitled to enforce the document of title (Section 7-102(a)(9)) and that person must surrender possession or control of the original document to the issuer. The reissued document must have a notation that it has been issued as a substitute for the original document. These minimum requirements must be met in order to give the substitute document effect and validity. If these minimum requirements are not met for issuance of a substitute document of title, the original document of title continues to be effective and valid. Section 7-402. However, if the minimum requirements imposed by this section are met, in addition to any other requirements that the issuer may impose, the substitute document will be the document that is effective and valid.

3. To protect parties who subsequently take the substitute document of title, the person who procured issuance of the substitute document warrants that it was a person entitled under the original document at the time it surrendered possession or control of the original document to the issuer. This warranty is modeled after the warranty found in Section 4-209.

Cross Reference: Sections 7-106, 7-402, and 7-601.

Definitional Cross Reference:

"Person entitled to enforce," Section 7-102.

4-7-106. Control of electronic document of title. (a) A person has control of an electronic document of title if a system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred.

(b) A system satisfies subsection (a) of this section, and a person is deemed to have control of an electronic document of title, if the document is created, stored, and assigned in such a manner that:

(1) A single authoritative copy of the document exists which is unique, identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6) of this subsection (b), unalterable;

(2) The authoritative copy identifies the person asserting control as:

(A) The person to which the document was issued; or

(B) If the authoritative copy indicates that the document has been transferred, the person to which the document was most recently transferred;

(3) The authoritative copy is communicated to and maintained by the person asserting control or its designated custodian;

(4) Copies or amendments that add or change an identified assignee of the authoritative copy can be made only with the consent of the person asserting control;

(5) Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) Any amendment of the authoritative copy is readily identifiable as authorized or unauthorized.

Source: L. 2006: Entire article R&RE, p. 472, § 2, effective September 1. **L. 2007:** (b)(1) amended, p. 366, § 5, effective August 3.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Uniform Electronic Transactions Act Section 16.

Purpose:

1. The section defines "control" for electronic documents of title and derives its rules from the Uniform Electronic Transactions Act § 16 on transferrable records. Unlike UETA § 16, however, a document of title may be reissued in an alternative medium pursuant to Section 7-105. At any point in time in which a document of title is in electronic form, the control concept of this section is relevant. As under UETA § 16, the control concept embodied in this section provides the legal framework for developing systems for electronic documents of title.

2. Control of an electronic document of title substitutes for the concept of indorsement and possession in the tangible document of title context. See Section 7-501. A person with a tangible document of title delivers the document by voluntarily transferring possession and a person with an electronic document of title delivers the document by voluntarily transferring control. (Delivery is defined in Section 1-201).

3. Subsection (a) sets forth the general rule that the "system employed for evidencing the transfer of interests in the electronic document

reliably establishes that person as the person to which the electronic document was issued or transferred." The key to having a system that satisfies this test is that identity of *the* person to which the document was issued or transferred must be reliably established. Of great importance to the functioning of the control concept is to be able to demonstrate, at any point in time, *the person* entitled under the electronic document. For example, a carrier may issue an electronic bill of lading by having the required information in a database that is encrypted and accessible by virtue of a password. If the computer system in which the required information is maintained identifies the person as *the* person to which the electronic bill of lading was issued or transferred, that person has control of the electronic document of title. That identification may be by virtue of passwords or other encryption methods. Registry systems may satisfy this test. For example, see the electronic warehouse receipt system established pursuant to 7 C.F.R. Part 735. This Article leaves to the market place the development of sufficient technologies and business practices that will meet the test.

An electronic document of title is evidenced by a record consisting of information stored in an electronic medium. Section 1-201. For example, a record in a computer database could be an electronic document of title assuming that it otherwise meets the definition of document of title. To the extent that third parties wish to deal in paper mediums, Section 7-105 provides a mechanism for exiting the electronic environment by having the issuer reissue the document of title in a tangible medium. Thus if a person entitled to enforce an electronic document of title causes the information in the record to be printed onto paper without the issuer's involvement in issuing the document of title pursuant to Section 7-105, that paper is not a document of title.

4. Subsection (a) sets forth the general test for control. Subsection (b) sets forth a safe harbor test that if satisfied, results in control under the general test in subsection (a). The test in subsection (b) is also used in Section 9-105 although Section 9-105 does not include the general test of subsection (a). Under subsection (b), at any point in time, a party should be able to identify the single authoritative copy which is unique and identifiable as the authoritative copy. This does not mean that once created that the authoritative copy need be static and never moved or copied from its original location. To the extent that backup systems exist which result in multiple copies, the key to this idea is that at any point in time, the one authoritative copy needs to be unique and identifiable.

Parties may not by contract provide that control exists. The test for control is a factual test that depends upon whether the general test in subsection (a) or the safe harbor in subsection (b) is satisfied.

5. Article 7 has historically provided for rights under documents of title and rights of transferees of documents of title as those rights relate to the goods covered by the document. Third parties may possess or have control of documents of title. While misfeasance or negligence in failure to transfer or misdelivery of the document by those third parties may create serious issues, this Article has never dealt with those issues as it relates to tangible documents of title, preferring to leave those issues to the law of contracts, agency and tort law. In the electronic document of title regime, third party registry systems are just beginning to develop. It is very difficult to write rules regulating those third parties without some definitive sense of how the third party registry systems will be structured. Systems that are evolving to date tend to be "closed" systems in which all participants must sign on to the master agreement which provides for rights as against the registry system as well as rights among the members. In those closed systems, the document of title never leaves the system so the parties rely upon the master agreement as to rights against the registry for its failures in dealing with the document. This article contemplates that those "closed" systems will continue to evolve and that the control mechanism in this statute provides a method for the participants in the closed system to achieve the benefits of obtaining control allowed by this article.

This article also contemplates that parties will evolve open systems where parties need not be subject to a master agreement. In an open system a party that is expecting to obtain rights through an electronic document may not be a party to the master agreement. To the extent that open systems evolve by use of the control concept contained in this section, the law of contracts, agency, and torts as it applies to the registry's misfeasance or negligence concerning the transfer of control of the electronic document will allocate the risks and liabilities of the parties as that other law now does so for third parties who hold tangible documents and fail to deliver the documents.

Cross Reference: Sections 7-105 and 7-501.

Definitional Cross-References:

"Delivery", 1-201.

"Document of title", 1-201.

4-7-107. Relation to federal "Electronic Signatures in Global and National Commerce Act". (Repealed)

Source: L. 2006: Entire article R&RE, p. 473, § 2, effective September 1. **L. 2007:** Entire section repealed, p. 366, § 6, effective August 3.

PART 2

WAREHOUSE RECEIPTS - SPECIAL PROVISIONS

4-7-201. Person that may issue a warehouse receipt - storage under bond. (a) A warehouse receipt may be issued by any warehouse.

(b) If goods, including distilled spirits and agricultural commodities, are stored under a statute requiring a bond against withdrawal or a license for the issuance of receipts in the nature of warehouse receipts, a receipt issued for the goods is deemed to be a warehouse receipt even if issued by a person that is the owner of the goods and is not a warehouse.

Source: L. 2006: Entire article R&RE, p. 473, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-201 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-201.
Changes: Update for style only.
Purposes:
It is not intended by re-enactment of subsection (a) to repeal any provisions of special licensing or other statutes regulating who may become a warehouse. Limitations on the transfer of the receipts and criminal sanctions for violation of such limitations are not impaired. Section 7-103. Compare Section 7-401(4) on the liability of the issuer in such cases. Subsection (b) covers receipts issued by the owner for whiskey or other goods stored in bonded warehouses under such statutes as 26 U.S.C. Chapter 51.
Cross References: Sections 7-103, 7-401.
Definitional Cross References:
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

ANNOTATION

Law reviews. For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965).

4-7-202. Form of warehouse receipt - effect of omission. (a) A warehouse receipt need not be in any particular form.

(b) Unless a warehouse receipt provides for each of the following, the warehouse is liable for damages caused to a person injured by its omission:

(1) A statement of the location of the warehouse facility where the goods are stored;

(2) The date of issue of the receipt;

(3) The unique identification code of the receipt;

(4) A statement whether the goods received will be delivered to the bearer, to a named person, or to a named person or on its order;

(5) The rate of storage and handling charges, unless goods are stored under a field warehousing arrangement, in which case a statement of that fact is sufficient on a nonnegotiable receipt;

(6) A description of the goods or the packages containing them;

(7) The signature of the warehouse or its agent;

(8) If the receipt is issued for goods that the warehouse owns, either solely, jointly, or in common with others, a statement of the fact of that ownership; and

(9) A statement of the amount of advances made and of liabilities incurred for which the warehouse claims a lien or security interest, unless the precise amount of advances made

or liabilities incurred, at the time of the issue of the receipt, is unknown to the warehouse or to its agent that issued the receipt, in which case a statement of the fact that advances have been made or liabilities incurred and the purpose of the advances or liabilities is sufficient.

(c) A warehouse may insert in its receipt any terms that are not contrary to the provisions of this title and do not impair its obligation of delivery under section 4-7-403 or its duty of care under section 4-7-204. Any contrary provision is ineffective.

Source: L. 2006: Entire article R&RE, p. 473, § 2, effective September 1. **L. 2007:** IP (b), (b)(1), (b)(5), (b)(8), (b)(9), and (c) amended, p. 366, § 7, effective August 3.

Editor's note: This section is similar to former § 4-7-202 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-202.
Changes: Language is updated to accommodate electronic commerce and to reflect modern style.
Purposes:

1. This section does not displace any particular legislation that requires other terms in a warehouse receipt or that may require a particular form of a warehouse receipt. This section does not require that a warehouse receipt be issued. A warehouse receipt that is issued need not contain any of the terms listed in subsection (b) in order to qualify as a warehouse receipt as long as the receipt falls within the definition of "warehouse receipt" in Article 1. Thus the title has been changed to eliminate the phrase "essential terms" as provided in prior law. The only consequence of a warehouse receipt not containing any term listed in subsection (b) is that a person injured by a term's omission has a right as against the warehouse for harm caused by the omission. Cases, such as In re Celotex Corp., 134 B.R. 993 (Bankr. M.D. Fla. 1991), that held that in order to have a valid warehouse receipt all of the terms listed in this section must be contained in the receipt, are disapproved.

2. The unique identification code referred to in subsection (b)(3) can include any combination of letters, number, signs, and/or symbols that provide a unique identification. Whether an electronic or tangible warehouse receipt contains a signature will be resolved with the definition of sign in Section 7-102.

Cross References: Sections 7-103 and 7-401.
Definitional Cross References:
"Bearer". Section 1-201.
"Delivery". Section 1-201.
"Goods". Section 7-102.
"Person". Section 1-201.
"Security interest". Section 1-201.
"Term". Section 1-201.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

4-7-203. Liability for nonreceipt or misdescription. A party to or purchaser for value in good faith of a document of title, other than a bill of lading, that relies upon the description of the goods in the document may recover from the issuer damages caused by the nonreceipt or misdescription of the goods, except to the extent that:

(1) The document conspicuously indicates that the issuer does not know whether all or part of the goods in fact were received or conform to the description, such as a case in which the description is in terms of marks or labels or kind, quantity, or condition, or the receipt or description is qualified by "contents, condition, and quality unknown", "said to contain", or words of similar import, if the indication is true; or

(2) The party or purchaser otherwise has notice of the nonreceipt or misdescription.

Source: L. 2006: Entire article R&RE, p. 474, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-203 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-203.
Changes: Changes to this section are for style only.
Purpose:
This section is a simplified restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of

descriptions which are made by or in reliance upon information furnished by the depositor. The issuer is liable on documents issued by an agent, contrary to instructions of its principal, without receiving goods. No disclaimer of the latter liability is permitted.

Cross Reference: Section 7-301.

Definitional Cross References:

"Conspicuous". Section 1-201.
"Document of title". Section 1-201.
"Goods". Section 7-102.
"Good Faith". Section 1-201. [7-102]
"Issuer". Section 7-102.
"Notice". Section 1-201.
"Party". Section 1-201.
"Purchaser". Section 1-201.
"Receipt of goods". Section 2-103.
"Value". Section 1-201.

ANNOTATION

Law reviews. For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965).

4-7-204. Duty of care - contractual limitation of warehouse's liability. (a) A warehouse is liable for damages for loss of or injury to the goods caused by its failure to exercise care with regard to the goods that a reasonably careful person would exercise under similar circumstances. Unless otherwise agreed, the warehouse is not liable for damages that could not have been avoided by the exercise of that care.

(b) Damages may be limited by a term in the warehouse receipt or storage agreement limiting the amount of liability in case of loss or damage beyond which the warehouse is not liable. Such a limitation is not effective with respect to the warehouse's liability for conversion to its own use. On request of the bailor in a record at the time of signing the storage agreement or within a reasonable time after receipt of the warehouse receipt, the warehouse's liability may be increased on part or all of the goods covered by the storage agreement or the warehouse receipt. In this event, increased rates may be charged based on an increased valuation of the goods.

(c) Reasonable provisions as to the time and manner of presenting claims and commencing actions based on the bailment may be included in the warehouse receipt or storage agreement.

Source: L. 2006: Entire article R&RE, p. 474, § 2, effective September 1. **L. 2007:** (a) and (b) amended, p. 367, § 8, effective August 3.

Editor's note: This section is similar to former § 4-7-204 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-204.

Changes: Updated to reflect modern, standard commercial practices.

Purposes of Changes:

1. Subsection (a) continues the rule without change from former Section 7-204 on the warehouse's obligation to exercise reasonable care.

2. Former Section 7-204(2) required that the term limiting damages do so by setting forth a specific liability per article or item or of a value per unit of weight. This requirement has been deleted as out of step with modern industry practice. Under subsection (b) a warehouse may limit its liability for damages for loss of or damage to the goods by a term in the warehouse receipt or storage agreement without the term constituting an impermissible disclaimer of the obligation of reasonable care. The parties cannot disclaim by contract the warehouse's obligation of care. Section 1-302. For example, limitations based upon per unit of weight, per package, per occurrence, or per receipt as well as limitations based upon a multiple of the storage rate may be commercially appropriate. As subsection (d) makes clear, the states or the federal government may supplement this section with more rigid standards of responsibility for some or all bailees.

3. Former Section 7-204(2) also provided that an increased rate can not be charged if contrary to a tariff. That language has been deleted. If a tariff is required under state or federal law, pursuant to Section 7-103(a), the tariff would control over the rule of this section allowing an increased rate. The provisions of a non-mandatory tariff may be incorporated by reference in the parties' agreement. See Com-

ment 2 to Section 7-103. Subsections (c) deletes the reference to tariffs for the same reason that the reference has been omitted in subsection (b).

4. As under former Section 7-204(2), subsection (b) provides that a limitation of damages is ineffective if the warehouse has converted the goods to its own use. A mere failure to redeliver the goods is not conversion to the warehouse's own use. See Adams v. Ryan & Christie Storage, Inc., 563 F. Supp. 409 (E.D. Pa. 1983) aff'd 725 F.2d 666 (3rd Cir. 1983). Cases such as I.C.C. Metals Inc. v. Municipal Warehouse Co., 409 B,E, 2d 849 (N.Y. Ct. App. 1980) holding that mere failure to redeliver results in a presumption of conversion to the warehouse's own use are disapproved. "Conversion to its own use is narrower than the idea of conversion generally." Cases such as Lipman v. Peterson, 575 P.2d 19 (Kan. 1978) holding to the contrary are disapproved.

5. Storage agreements commonly establish the contractual relationship between warehouses and depositors who have an on-going relationship. The storage agreement may allow for the movement of goods into and out of a warehouse without the necessity of issuing or amending a warehouse receipt upon each entry or exit of goods from the warehouse.

Cross References: Sections 1-302, 7-103, 7-309 and 7-403.

Definitional Cross References:

"Goods". Section 7-102.
"Reasonable time". Section 1-204.
"Sign". Section 1-201.
"Term". Section 1-201.
"Value". Section 1-204.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

ANNOTATION

I. GENERAL CONSIDERATION.

Annotator's note. Since § 4-7-204 is similar to § 4-7-204 as it existed prior to the 2006 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Measure of damages. Where household goods, wearing apparel, and personal effects of a bailor have a market value, then the measure of damages for negligent harm to personal property bailed with a warehouseman is the difference between the fair market value of the goods at the time the injury was discovered and what would have been the fair market value at that time if the goods had not been damaged. Keefe v. Bekins Van & Storage Co., 36 Colo. App. 382, 540 P.2d 1132 (1975).

Original costs of goods which were damaged while in possession of a warehouseman may be considered in determining market value, but only if combined with other factors such as the length of time the property has been used, its condition just before, and its salvage value after the damage occurred. Keefe v. Bekins Van & Storage Co., 36 Colo. App. 382, 540 P.2d 1132 (1975).

Where an item, while in the possession of a warehouseman, is merely damaged and is repairable at reasonable expense, the cost of repairs may be used as the measure of damages. Keefe v. Bekins Van & Storage Co., 36 Colo. App. 382, 540 P.2d 1132 (1975).

Where articles which have been damaged while in the possession of a warehouseman have no market value in the ordinary sense, they may be given a reasonable value on the basis of their value to the owner, and for this purpose, original cost and the practicability and expense of replacement can be considered. Keefe v. Bekins Van & Storage Co., 36 Colo. App. 382, 540 P.2d 1132 (1975).

II. DUTY OF CARE.

Law reviews. For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965).

Annotator's note. Since § 4-7-204(1) is similar to repealed § 147-2-14, C.R.S. 1963, § 146-2-14, CRS 53, and laws antecedent to CSA, C. 173, § 21 (uniform warehouse receipts act), relevant cases construing those provisions have been included in the annotations to this section.

The legal relationship created in warehousing is that of bailor-bailee. Burroughs Corp. v. Rocky Mt. Prestress, Inc., 431 F.2d 1185 (10th Cir. 1970).

Bound only to common care. It is well settled that warehousemen are not like common carriers, insurers of goods committed to their care and liable for all losses not occasioned by the act of God or a public enemy, but are ordinary bailees for hire, bound only to common care and diligence and liable only for want of such diligence and care. Benedict Whse. & Transf. Co. v. McKannon Piano Co., 62 Colo. 180, 161 P. 145 (1916).

Warehousemen are liable for loss due to their negligence. See Denver Union Term. Ry. v. Cullinan, 72 Colo. 248, 210 P. 602 (1922).

When there is substantial evidence upon the issue, the question of reasonable care is

for the jury, in view of all the surrounding circumstances. Benedict Whse. & Transf. Co. v. McKannon Piano Co., 62 Colo. 180, 161 P. 145 (1916).

In the absence of evidence, the question of reasonable care is for the court. Benedict Whse. & Transf. Co. v. McKannon Piano Co., 62 Colo. 180, 161 P. 145 (1916).

Appellate court must accept trier of fact's conclusion. The issues of negligence and proximate cause are to be resolved by the trier of the fact, and upon review the appellate court must view the evidence in the light most favorable to the party in whose favor the trier of the fact resolved the inferences to be drawn from the evidence. Hipps v. Hennig, 167 Colo. 358, 447 P.2d 700 (1968).

An appellate court can reach a conclusion of what constitutes reasonable care or proximate cause different from the one reached by the trier of the fact, only in the clearest cases where the facts are undisputed and reasonable minds could draw but one inference from them. Hipps v. Hennig, 167 Colo. 358, 447 P.2d 700 (1968).

It cannot be said that a warehouseman is required to foresee, as a matter of law, that the distribution of keys to other tenants or users of the building could result in a fire being set. Hipps v. Hennig, 167 Colo. 358, 447 P.2d 700 (1968).

It cannot be said that as a matter of law all warehousemen must employ a night watchman or put in an automatic sprinkler system, and that the failure to do so subjects the warehouseman to liability for any fire which occurs on the premises. Hipps v. Hennig, 167 Colo. 358, 447 P.2d 700 (1968).

To establish a prima facie case the bailor need only show that the goods were delivered to the bailee in good condition and that the bailee returned the goods in a damaged condition. Burroughs Corp. v. Rocky Mt. Prestress, Inc., 431 F.2d 1185 (10th Cir. 1970). See Bankers Whse. Co. v. Bennett, 148 Colo. 323, 365 P.2d 889 (1961).

As a presumption of negligence arises. Once goods are delivered in good condition to a warehouseman who accepts them, but cannot redeliver them, or can redeliver them only in a damaged condition, a presumption of negligence on the part of the warehouseman arises. Hipps v. Hennig, 167 Colo. 358, 447 P.2d 700 (1968); Burroughs Corp. v. Rocky Mt. Prestress, Inc., 431 F.2d 1185 (10th Cir. 1970).

Where in February, 1973, a warehouseman accepted the bailor's goods for storage and redelivered them in September, 1973, in a water-damaged condition, under these circumstances a presumption of negligence on the part of the warehouseman arose. Keefe v. Bekins Van & Storage Co., 36 Colo. App. 382, 540 P.2d 1132 (1975).

The burden of going forward with evidence to rebut that presumption rests on the warehouseman. Bankers Whse. Co. v. Bennett, 148 Colo. 323, 365 P.2d 889 (1961); Hipps v. Hennig, 167 Colo. 358, 447 P.2d 700 (1968); Burroughs Corp. v. Rocky Mt. Prestress, Inc., 431 F.2d 1185 (10th Cir. 1970); Keefe v. Bekins Van & Storage Co., 36 Colo. App. 382, 540 P.2d 1132 (1975).

Once the bailor has established these facts, it is incumbent on the bailee to come forward with evidence to show that the goods were returned in good condition, or that there exists some acceptable explanation as to why they were returned in a damaged condition. Burroughs Corp. v. Rocky Mt. Prestress, Inc., 431 F.2d 1185 (10th Cir. 1970).

The effect of this rule requiring the bailee to meet the presumption of negligence is to place the burden upon the one best able to discharge it. Bankers Whse. Co. v. Bennett, 148 Colo. 323, 365 P.2d 889 (1961).

An essential part of every bailment contract is the obligation to deliver over the property at the termination of the bailment. The bailor must prove the contract, the delivery of the goods to the bailee, and their return in a damaged condition. When he has done this, the inference is deducible that the bailee is at fault and must answer, and especially is this true if the loss could not ordinarily have occurred without negligence. His failure to return the goods as delivered to him is inconsistent with what he agreed to do. The property was in his possession, under his care and oversight, and away from that of the bailor, who in most cases could not know under what circumstances it was damaged. Bankers Whse. Co. v. Bennett, 148 Colo. 323, 365 P.2d 889 (1961).

There is, however, no shift in the burden of proof which still remains with the bailor. Hipps v. Hennig, 167 Colo. 358, 447 P.2d 700 (1968); Burroughs Corp. v. Rocky Mt. Prestress, Inc., 431 F.2d 1185 (10th Cir. 1970).

Where foodstuffs are received by a warehouse in good marketable condition but are later contaminated while in storage, the question is, whether the warehouseman, if he had been the owner engaged in the sale, storage, and distribution of such would permit them to be stored with or come in contact with anything which would impregnate them with an odor, inasmuch as one engaged in such a business as storage of foodstuffs would presumably know of their susceptibility to absorb or acquire the taste and odor of other substances and take measures to guard against resulting contamination. Bankers Whse. Co. v. Bennett, 148 Colo. 323, 365 P.2d 889 (1961).

III. CONTRACTUAL LIMITATION.

Annotator's note. Since § 4-7-204(2) is similar to repealed CSA, C. 173, § 3 (uniform

warehouse receipts act), a relevant case construing that provision has been included in the annotations to this section.

Any attempt by provision in a warehouse receipt to absolve warehousemen from all liability resulting from failure to exercise ordinary care is invalid, and it has been so held in some jurisdictions independent of statute on the ground of public policy. French v. Bekins Moving & Storage Co., 118 Colo. 424, 195 P.2d 968 (1948).

A provision in the contract between the parties declaring an agreed valuation of the goods stored which is less than their true value for the purpose of determining the measure of the warehousemen's obligation does not impair the obligation under this section if: (a) the parties fairly agree as to the valuation, and (b) the fact of actually greater value is unknown to the warehousemen. French v. Bekins Moving & Storage Co., 118 Colo. 424, 195 P.2d 968 (1948).

Limitation not called to bailor's attention. Under the plain language of subsection (2), the liability of a warehouseman can be limited to the amount specified in a warehouse receipt, even though this limitation was not called specifically to the bailor's attention by the warehouseman. Keefe v. Bekins Van & Storage Co., 36 Colo. App. 382, 540 P.2d 1132 (1975).

4-7-205. Title under warehouse receipt defeated in certain cases. A buyer in ordinary course of business of fungible goods sold and delivered by a warehouse that is also in the business of buying and selling such goods takes the goods free of any claim under a warehouse receipt even if the receipt is negotiable and has been duly negotiated.

Source: L. 2006: Entire article R&RE, p. 474, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-205 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-205.

Changes: Changes for style only.

Purposes:

1. The typical case covered by this section is that of the warehouse-dealer in grain, and the substantive question at issue is whether in case the warehouse becomes insolvent the receipt holders shall be able to trace and recover grain shipped to farmers and other purchasers from the elevator. This was possible under the old acts, although courts were eager to find estoppels to prevent it. The practical difficulty of tracing fungible grain means that the preservation of this theoretical right adds little to the commercial acceptability of negotiable grain receipts, which really circulate on the credit of the warehouse. Moreover, on default of the warehouse, the receipt holders at least share in what grain remains, whereas retaking the grain from a good faith cash purchaser reduces the purchaser completely to the status of general creditor in a situation where there was very little the purchaser could do to guard against the loss. Compare 15 U.S.C. Section 714p enacted in 1955.

2. This provision applies to both negotiable and nonnegotiable warehouse receipts. The concept of due negotiation is provided for in 7-501. The definition of "buyer in ordinary course" is in Article 1 and provides, among other things, that a buyer must either have possession or a right to obtain the goods under Article 2 in order to be a buyer in ordinary course. This section requires actual delivery of the fungible goods to the buyer in ordinary course. Delivery requires voluntary transfer of possession of the fungible goods to the buyer. See amended Section 2-103. This section is not satisfied by the delivery of the document of title to the buyer in ordinary course.

Cross References: Sections 2-403 and 9-320.

Definitional Cross References:

"Buyer in ordinary course of business". Section 1-201.

"Delivery". Section 1-201.

"Duly negotiate". Section 7-501.

"Fungible" goods. Section 1-201.

"Goods". Section 7-102.

"Value". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouse". Section 7-102.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Annotator's note. Since § 4-7-205 is similar to § 4-7-205 as it existed prior to the 2006 repeal and reenactment of this article, a relevant case construing that provision has been included in the annotations to this section.

This section requires that the goods in question be delivered. Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976).

"Delivered" under this section means delivered in fact, not symbolic delivery by means of a transfer of documents. Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976).

4-7-206. Termination of storage at warehouse's option. (a) A warehouse, by giving notice to the person on whose account the goods are held and any other person known to claim an interest in the goods, may require payment of any charges and removal of the goods from the warehouse at the termination of the period of storage fixed by the document of title or, if a period is not fixed, within a stated period not less than thirty days after the warehouse gives notice. If the goods are not removed before the date specified in the notice, the warehouse may sell them pursuant to section 4-7-210.

(b) If a warehouse in good faith believes that goods are about to deteriorate or decline in value to less than the amount of its lien within the time provided in subsection (a) of this section and section 4-7-210, the warehouse may specify in the notice given under subsection (a) of this section any reasonable shorter time for removal of the goods and, if the goods are not removed, may sell them at public sale held not less than one week after a single advertisement or posting.

(c) If, as a result of a quality or condition of the goods of which the warehouse did not have notice at the time of deposit, the goods are a hazard to other property, the warehouse facilities, or other persons, the warehouse may sell the goods at public or private sale without advertisement or posting on reasonable notification to all persons known to claim an interest in the goods. If the warehouse, after a reasonable effort, is unable to sell the goods, it may dispose of them in any lawful manner and does not incur liability by reason of that disposition.

(d) A warehouse shall deliver the goods to any person entitled to them under this article upon due demand made at any time before sale or other disposition under this section.

(e) A warehouse may satisfy its lien from the proceeds of any sale or disposition under this section but shall hold the balance for delivery on the demand of any person to which the warehouse would have been bound to deliver the goods.

Source: L. 2006: Entire article R&RE, p. 475, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-206 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-206.

Changes: Changes for style.

Purposes:

1. This section provides for three situations in which the warehouse may terminate storage for reasons other then enforcement of its lien as permitted by Section 7-210. Most warehousing is for an indefinite term, the bailor being entitled to delivery on reasonable demand. It is necessary to define the warehouse's power to terminate the bailment, since it would be commercially intolerable to allow warehouses to order removal of the goods on short notice. The thirty day period provided where the document does not carry its own period of termination corresponds to commercial practice of computing rates on a monthly basis. The right to terminate under subsection (a) includes a right to require payment of "any charges", but does not depend on the existence of unpaid charges.

2. In permitting expeditious disposition of perishable and hazardous goods the pre- Code Uniform Warehouse Receipts Act, Section 34, made no distinction between cases where the warehouse knowingly undertook to store such goods and cases where the goods were discovered to be of that character subsequent to storage. The former situation presents no such emergency as justifies the summary power of removal and sale. Subsections (b) and (c) distinguish between the two situations.

3. Protection of its lien is the only interest which the warehouse has to justify summary sale of perishable goods which are not hazardous. This same interest must be recognized when the stored goods, although not perishable, decline in market value to a point which threat-

ens the warehouse's security. The reason of this section should apply if the goods become hazardous during the course of storage. The process for selling the goods transcribed in Section 7-210 governs the sale of goods under this section except as provided in subsections (b) and (c) for the situations described in those subsections respectively.

4. The right to order removal of stored goods is subject to provisions of the public warehousing laws of some states forbidding warehouses from discriminating among customers. Nor does the section relieve the warehouse of any obligation under the state laws to secure the approval of a public official before disposing of deteriorating goods. Such regulatory statutes and the regulations under them remain in force and operative. Sections 7-103.

Cross References: Sections 7-103 and 7-403.

Definitional Cross References:

"Delivery". Section 1-201.
"Document". Section 1-102.
"Good faith". Section 1-201 [7-102].
"Goods". Section 7-102.
"Notice". Section 1-202.
"Notification". Section 1-202.
"Person". Section 1-201.
"Reasonable time". Section 1-205.
"Value". Section 1-204.
"Warehouse". Section 7-102.

4-7-207. Goods must be kept separate - fungible goods. (a) Unless the warehouse receipt provides otherwise, a warehouse shall keep separate the goods covered by each receipt so as to permit at all times identification and delivery of those goods. However, different lots of fungible goods may be commingled.

(b) If different lots of fungible goods are commingled, the goods are owned in common by the persons entitled thereto and the warehouse is severally liable to each owner for that owner's share. If, because of overissue, a mass of fungible goods is insufficient to meet all the receipts the warehouse has issued against it, the persons entitled include all holders to which overissued receipts have been duly negotiated.

Source: L. 2006: Entire article R&RE, p. 475, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-207 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-207.

Changes: Changes for style only.

Purposes:

No change of substance is made from former Section 7-207. Holders to whom overissued receipts have been duly negotiated shall share in a mass of fungible goods. Where individual ownership interests are merged into claims on a common fund, as is necessarily the case with fungible goods, there is no policy reason for discriminating between successive purchasers of similar claims.

Definitional Cross References:

"Delivery". Section 1-201.
"Duly negotiate". Section 7-501.
"Fungible" goods. Section 1-201.
"Goods". Section 7-102.
"Holder". Section 1-201.
"Person". Section 1-201.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

ANNOTATION

Applied in Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976) (decided prior to the 2006 repeal and reenactment).

4-7-208. Altered warehouse receipts. If a blank in a negotiable tangible warehouse receipt has been filled in without authority, a good-faith purchaser for value and without notice of the lack of authority may treat the insertion as authorized. Any other unauthorized alteration leaves any tangible or electronic warehouse receipt enforceable against the issuer according to its original tenor.

Source: L. 2006: Entire article R&RE, p. 476, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-208 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-208.
Changes: To accommodate electronic documents of title.
Purpose:
1. The execution of tangible warehouse receipts in blank is a dangerous practice. As between the issuer and an innocent purchaser the risks should clearly fall on the former. The purchaser must have purchased the tangible negotiable warehouse receipt in good faith and for value to be protected under the rule of the first sentence which is a limited exception to the general rule in the second sentence. Electronic document of title systems should have protection against unauthorized access and unauthorized changes. See 7-106. Thus the protection for good faith purchasers found in the first sentence is not necessary in the context of electronic documents.
2. Under the second sentence of this section, an unauthorized alteration whether made with or without fraudulent intent does not relieve the issuer of its liability on the warehouse receipt as originally executed. The unauthorized alteration itself is of course ineffective against the warehouse. The rule stated in the second sentence applies to both tangible and electronic warehouse receipts.
Definitional Cross References:
"Good faith". Section 1-201 [7-102].
"Issuer". Section 7-102.
"Notice". Section 1-202.
"Purchaser". Section 1-201.
"Value". Section 1-204.
"Warehouse receipt". Section 1-201.

4-7-209. Lien of warehouse. (a) A warehouse has a lien against the bailor on the goods covered by a warehouse receipt or storage agreement or on the proceeds thereof in its possession for charges for storage or transportation, including demurrage and terminal charges, insurance, labor, or other charges, present or future, in relation to the goods, and for expenses necessary for preservation of the goods or reasonably incurred in their sale pursuant to law. If the person on whose account the goods are held is liable for similar charges or expenses in relation to other goods whenever deposited and it is stated in the warehouse receipt or storage agreement that a lien is claimed for charges and expenses in relation to other goods, the warehouse also has a lien against the goods covered by the warehouse receipt or storage agreement or on the proceeds thereof in its possession for those charges and expenses, whether or not the other goods have been delivered by the warehouse. However, as against a person to which a negotiable warehouse receipt is duly negotiated, a warehouse's lien is limited to charges in an amount or at a rate specified in the warehouse receipt or, if no charges are so specified, to a reasonable charge for storage of the specific goods covered by the receipt subsequent to the date of the receipt.

(b) A warehouse may also reserve a security interest against the bailor for the maximum amount specified on the receipt for charges other than those specified in subsection (a) of this section, such as for money advanced and interest. The security interest is governed by article 9 of this title.

(c) A warehouse's lien for charges and expenses under subsection (a) of this section or a security interest under subsection (b) of this section is also effective against any person that so entrusted the bailor with possession of the goods that a pledge of them by the bailor to a good-faith purchaser for value would have been valid. However, the lien or security interest is not effective against a person that before issuance of a document of title had a legal interest or a perfected security interest in the goods and that did not:

(1) Deliver or entrust the goods or any document of title covering the goods to the bailor or the bailor's nominee with:

(A) Actual or apparent authority to ship, store, or sell;

(B) Power to obtain delivery under section 4-7-403; or

(C) Power of disposition under section 4-2-403, 4-2.5-304 (2), 4-2.5-305 (2), 4-9-320, or 4-9-321 (c) or other statute or rule of law; or

(2) Acquiesce in the procurement by the bailor or its nominee of any document.

(d) A warehouse's lien on household goods for charges and expenses in relation to the goods under subsection (a) of this section is also effective against all persons if the depositor was the legal possessor of the goods at the time of deposit. In this subsection (d), "household goods" means furniture, furnishings, or personal effects used by the depositor in a dwelling.

(e) A warehouse loses its lien on any goods that it voluntarily delivers or unjustifiably refuses to deliver.

Source: L. 2006: Entire article R&RE, p. 476, § 2, effective September 1. **L. 2007:** (b) and (c)(1) amended, p. 367, § 9, effective August 3.

Editor's note: This section is similar to former §§ 4-7-209 and 4-7-503 as they existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Sections 7-209 and 7-503.

Changes: Expanded to recognize warehouse lien when a warehouse receipt is not issued but goods are covered by a storage agreement.

Purposes:

1. Subsection (a) defines the warehouse's statutory lien. Other than allowing a warehouse to claim a lien under this section when there is a storage agreement and not a warehouse receipt, this section remains unchanged in substance from former Section 7-209(1). Under the first sentence, a specific lien attaches automatically without express notation on the receipt or storage agreement with regard to goods stored under the receipt or the storage agreement. That lien is limited to the usual charges arising out of a storage transaction.

Example 1: Bailor stored goods with a warehouse and the warehouse issued a warehouse receipt. A lien against those goods arose as set forth in subsection (a), the first sentence, for the charges for storage and the other expenses of those goods. The warehouse may enforce its lien under Section 7-210 as against the bailor. Whether the warehouse receipt is negotiable or nonnegotiable is not important to the warehouse's rights as against the bailor.

Under the second sentence, by notation on the receipt or storage agreement, the lien can be made a general lien extending to like charges in relation to other goods. Both the specific lien and general lien are as to goods in the possession of the warehouse and extend to proceeds from the goods as long as the proceeds are in the possession of the warehouse. The same rules apply whether the receipt is negotiable or nonnegotiable.

Example 2: Bailor stored goods (lot A) with a warehouse and the warehouse issued a warehouse receipt for those goods. In the warehouse receipt it is stated that the warehouse will also have a lien on goods covered by the warehouse receipt for storage charges and the other expenses for any other goods that are stored with the warehouse by the bailor. The statement about the lien on other goods does not specify an amount or a rate. Bailor then stored other goods (lot B) with the warehouse. Under subsection (a), first sentence, the warehouse has a lien on the specific goods (lot A) covered by the warehouse receipt. Under subsection (a), second sentence, the warehouse has a lien on the goods in lot A for the storage charges and the other expenses arising from the goods in lot B. That lien is enforceable as against the bailor regardless of whether the receipt is negotiable or nonnegotiable.

Under the third sentence, if the warehouse receipt is negotiable, the lien as against a holder of that receipt by due negotiation is limited to the amount or rate specified on the receipt for the specific lien or the general lien, or, if none is specified, to a reasonable charge for storage of the specific goods covered by the receipt for storage after the date of the receipt.

Example 3: Same facts as Example 1 except that the warehouse receipt is negotiable and has been duly negotiated (Section 7-501) to a person other than the bailor. Under the last sentence of subsection (a), the warehouse may enforce its lien against the bailor's goods stored in the warehouse as against the person to whom the negotiable warehouse receipt has been duly negotiated. Section 7-502. That lien is limited to the charges or rates specified in the receipt or a reasonable charge for storage as stated in the last sentence of subsection (a).

Example 4: Same facts as Example 2 except that the warehouse receipt is negotiable and has been duly negotiated (Section 7-501) to a person other than the bailor. Under the last sentence of subsection (a), the lien on lot A goods for the storage charges and the other expenses arising from storage of lot B goods is not enforceable as against the person to whom the receipt has been duly negotiated. Without a statement of a specified amount or rate for the general lien, the warehouse's general lien is not enforceable as against the person to whom the negotiable document has been duly negotiated. However, the warehouse lien for charges and expenses related to storage of lot A goods is still enforceable as against the person to whom the receipt was duly negotiated.

Example 5. Same facts as Examples 2 and 4 except the warehouse had stated on the negotiable warehouse receipt a specified amount or rate for the general lien on other goods (lot B). Under the last sentence of subsection (a), the

general lien on lot A goods for the storage charges and the other expenses arising from storage of lot B goods is enforceable as against the person to whom the receipt has been duly negotiated.

2. Subsection (b) provides for a security interest based upon agreement. Such a security interest arises out of relations between the parties other than bailment for storage or transportation, as where the bailee assumes the role of financier or performs a manufacturing operation, extending credit in reliance upon the goods covered by the receipt. Such a security interest is not a statutory lien. Compare Sections 9-109 and 9-333. It is governed in all respects by Article 9, except that subsection (b) requires that the receipt specify a maximum amount and limits the security interest to the amount specified. A warehouse could also take a security interest to secure its charges for storage and the other expenses listed in subsection (a) to protect these claims upon the loss of the statutory possessory warehouse lien if the warehouse loses possession of the goods as provided in subsection (e).

Example 6: Bailor stores goods with a warehouse and the warehouse issues a warehouse receipt that states that the warehouse is taking a security interest in the bailed goods for charges of storage, expenses , for money advanced, for manufacturing services rendered, and all other obligations that the bailor may owe the warehouse. That is a security interest covered in all respects by Article 9. Subsection (b). As allowed by this section, a warehouse may rely upon its statutory possessory lien to protect its charges for storage and the other expenses related to storage. For those storage charges covered by the statutory possessory lien, the warehouse is not required to use a security interest under subsection (b).

3. Subsections (a) and (b) validate the lien and security interest "against the bailor." Under basic principles of derivative rights as provided in Section 7-504, the warehouse lien is also valid as against parties who obtain their rights from the bailor except as otherwise provided in subsection (a), third sentence, or subsection (c).

Example 7: Bailor stores goods with a warehouse and the warehouse issues a nonnegotiable warehouse receipt that also claims a general lien in other goods stored with the warehouse. A lien on the bailed goods for the charges for storage and the other expenses arises under subsection (a). Bailor notifies the warehouse that the goods have been sold to Buyer and the bailee acknowledges that fact to the Buyer. Section 2-503. The warehouse lien for storage of those goods is effective against Buyer for both the specific lien and the general lien. Section 7-504.

Example 8: Bailor stores goods with a warehouse and the warehouse issues a nonnegotiable warehouse receipt. A lien on the bailed goods for the charges for storage and the other expenses arises under subsection (a). Bailor grants a security interest in the goods while the goods are in the warehouse's possession to Secured Party (SP) who properly perfects a security interest in the goods. See Revised 9-312(d). The warehouse lien is superior in priority over SP's security interest. See Revised 9-203(b)(2) (debtor can grant a security interest to the extent of debtor's rights in the collateral).

Example 9: Bailor stores goods with a warehouse and the warehouse issues a negotiable warehouse receipt. A lien on the bailed goods for the charges for storage and the other expenses arises under subsection (a). Bailor grants a security interest in the negotiable document to SP. SP properly perfects its interest in the negotiable document by taking possession through a 'due negotiation.' Revised 9-312(c). SP's security interest is subordinate to the warehouse lien. Section 7-209(a), third sentence. Given that bailor's rights are subject to the warehouse lien, the bailor cannot grant to the SP greater rights than the bailor has under Section 9-203(b)(2), perfection of the security interest in the negotiable document and the goods covered by the document through SP's filing of a financing statement should not give a different result.

As against third parties who have interests in the goods prior to the storage with the warehouse, subsection (c) continues the rule under the prior uniform statutory provision that to validate the lien or security interest of the warehouse, the owner must have entrusted the goods to the depositor, and that the circumstances must be such that a pledge by the depositor to a good faith purchaser for value would have been valid. Thus the owner's interest will not be subjected to a lien or security interest arising out of a deposit of its goods by a thief. The warehouse may be protected because of the actual, implied or apparent authority of the depositor, because of a Factor's Act, or because of other circumstances which would protect a bona fide pledgee, unless those circumstances are denied effect under the second sentence of subsection (c). The language of Section 7-503 is brought into subsection (c) for purposes of clarity. The comments to Section 7-503 are helpful in interpreting delivery, entrustment or acquiescence.

Where the third party is the holder of a security interest, obtained prior to the issuance of a negotiable warehouse receipt, the rights of the warehouse depend on the priority given to a hypothetical bona fide pledgee by Article 9, particularly Section 9-322. Thus the special priority granted to statutory liens by Section 9-333 does not apply to liens under subsection (a) of this section, since subsection (c), second sentence, "expressly provides otherwise" within the meaning of Section 9-333.

As to household goods, however, subsection (d) makes the warehouse's lien "for charges and expenses in relation to the goods" effective

against all persons if the depositor was the legal possessor. The purpose of the exception is to permit the warehouse to accept household goods for storage in sole reliance on the value of the goods themselves, especially in situations of family emergency.

Example 10: Bailor grants a perfected security interest in the goods to SP prior to storage of the goods with the warehouse. Bailor then stores goods with the warehouse and the warehouse issues a warehouse receipt for the goods. A warehouse lien on the bailed goods for the charges for storage or other expenses arises under subsection (a). The warehouse lien is not effective as against SP unless SP entrusted the goods to the bailor with actual or apparent authority to ship store, or sell the goods or with power of disposition under subsection (c)(1) or acquiesced in the bailor's procurement of a document of title under subsection (c)(2). This result obtains whether the receipt is negotiable or nonnegotiable.

Example 11: Sheriff who had lawfully repossessed household goods in an eviction action stored the goods with a warehouse. A lien on the bailed goods arises under subsection (a). The lien is effective as against the owner of the goods. Subsection (d).

4. As under previous law, this section creates a statutory possessory lien in favor of the warehouse on the goods stored with the warehouse or on the proceeds of the goods. The warehouse loses its lien if it loses possession of the goods or the proceeds. Subsection (e).

5. Where goods have been stored under a non-negotiable warehouse receipt and are sold by the person to whom the receipt has been issued, frequently the goods are not withdrawn by the new owner. The obligations of the seller of the goods in this situation are set forth in Section 2-503(4) on tender of delivery and include procurement of an acknowledgment by the bailee of the buyer's right to possession of the goods. If a new receipt is requested, such an acknowledgment can be withheld until storage charges have been paid or provided for. The statutory lien for charges on the goods sold, granted by the first sentence of subsection (a), continues valid unless the bailee gives it up. See Section 7- 403. But once a new receipt is issued to the buyer, the buyer becomes "the person on whose account the goods are held" under the second sentence of subsection (a); unless the buyer undertakes liability for charges in relation to other goods stored by the seller, there is no general lien against the buyer for such charges. Of course, the bailee may preserve the general lien in such a case either by an arrangement by which the buyer "is liable for" such charges, or by reserving a security interest under subsection (b).

6. A possessory warehouse lien arises as provided under subsection (a) if the parties to the bailment have a storage agreement or a warehouse receipt is issued. In the modern warehouse, the bailor and the bailee may enter into a master contract governing the bailment with the bailee and bailor keeping track of the goods stored pursuant to the master contract by notation on their respective books and records and the parties send notification via electronic communication as to what goods are covered by the master contract. Warehouse receipts are not issued. See Comment 4 to Section 7-204. There is no particular form for a warehouse receipt and failure to contain any of the terms listed in Section 7-202 does not deprive the warehouse of its lien that arises under subsection (a). See the comment to Section 7-202.

Cross References:

Point 1: Sections 7-501 and 7-502.
Point 2: Sections 9-109 and 9-333.
Point 3: Sections 2-503, 7-503, 7-504, 9-203, 9-312, and 9-322 .
Point 4: Sections 2-503, 7-501, 7-502, 7-504, 9-312, 9-331, 9-333, 9-401.
Point 5: Sections 2-503 and 7-403.
Point 6: Sections 7-202 and 7-204.

Definitional Cross References:

"Deliver". Section 1-201.
"Document of Title". Section 1-201.
"Goods". Section 7-102.
"Money". Section 1-201.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Right". Section 1-201.
"Security interest". Section 1-201.
"Value". Section 1-204.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

4-7-210. Enforcement of warehouse's lien. (a) Except as otherwise provided in subsection (b) of this section, a warehouse's lien may be enforced by public or private sale of the goods, in bulk or in packages, at any time or place and on any terms that are commercially reasonable, after notifying all persons known to claim an interest in the goods. The notification must include a statement of the amount due, the nature of the proposed sale, and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a method different from that selected by the warehouse is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. The warehouse sells in a commercially reasonable manner if the warehouse sells the goods in the usual manner in any recognized market therefore, sells at the price current in that market at the time of the sale, or otherwise sells

in conformity with commercially reasonable practices among dealers in the type of goods sold. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable, except in cases covered by the preceding sentence.

(b) A warehouse may enforce its lien on goods, other than goods stored by a merchant in the course of its business, only if the following requirements are satisfied:

(1) All persons known to claim an interest in the goods are notified.

(2) The notification includes an itemized statement of the claim, a description of the goods subject to the lien, a demand for payment within a specified time not less than ten days after receipt of the notification, and a conspicuous statement that unless the claim is paid within that time, the goods will be advertised for sale and sold by auction at a specified time and place.

(3) The sale conforms to the terms of the notification.

(4) The sale is held at the nearest suitable place to where the goods are held or stored.

(5) After the expiration of the time given in the notification, an advertisement of the sale must be published once a week for two weeks consecutively in a newspaper of general circulation where the sale is to be held. The advertisement must include a description of the goods, the name of the person on whose account the goods are being held, and the time and place of the sale. The sale must take place at least fifteen days after the first publication. If there is no newspaper of general circulation where the sale is to be held, the advertisement must be posted at least ten days before the sale in not fewer than six conspicuous places in the neighborhood of the proposed sale.

(c) Before any sale held pursuant to this section, any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred in complying with this section. In that event, the goods may not be sold but must be retained by the warehouse subject to the terms of the receipt and this article.

(d) A warehouse may buy at any public sale held pursuant to this section.

(e) A purchaser in good faith of goods sold to enforce a warehouse's lien takes the goods free of any rights of persons against which the lien was valid, despite the warehouse's noncompliance with this section.

(f) A warehouse may satisfy its lien from the proceeds of any sale pursuant to this section but shall hold the balance, if any, for delivery on demand to any person to which the warehouse would have been bound to deliver the goods.

(g) The rights provided by this section are in addition to all other rights allowed by law to a creditor against a debtor.

(h) If a lien is on goods stored by a merchant in the course of its business, the lien may be enforced in accordance with subsection (a) or (b) of this section.

(i) A warehouse is liable for damages caused by failure to comply with the requirements for sale under this section and, in case of willful violation, is liable for conversion.

Source: L. 2006: Entire article R&RE, p. 477, § 2, effective September 1. **L. 2007:** (a), IP(b), and (b)(5) amended, p. 368, § 10, effective August 3.

Editor's note: This section is similar to former § 4-7-210 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-210.

Changes: Update to accommodate electronic commerce and for style.

Purposes:

1. Subsection (a) makes "commercial reasonableness" the standard for foreclosure proceedings in all cases except non-commercial storage with a warehouse. The latter category embraces principally storage of household goods by private owners; and for such cases the detailed provisions as to notification, publication and public sale are retained in subsection (b) with one change. The requirement in former Section 7-210(2)(b) that the notification must be sent in person or by registered or certified mail has been deleted. Notification may be sent by any reasonable means as provided in Section 1-202. The swifter, more flexible procedure of subsection (a) is appropriate to commercial storage. Compare seller's power of resale on breach by buyer under the provisions of the Article on

Sales (Section 2-706). Commercial reasonableness is a flexible concept that allows for a wide variety of actions to satisfy the rule of this section, including electronic means of posting and sale.

2. The provisions of subsections (d) and (e) permitting the bailee to bid at public sales and confirming the title of purchasers at foreclosure sales are designed to secure more bidding and better prices and remain unchanged from former Section 7-210.

3. A warehouses may have recourse to an interpleader action in appropriate circumstances. See Section 7-603.

4. If a warehouse has both a warehouse lien and a security interest, the warehouse may enforce both the lien and the security interest simultaneously by using the procedures of Article 9. Section 7-210 adopts as its touchstone "commercial reasonableness" for the enforcement of a warehouse lien. Following the procedures of Article 9 satisfies "commercial reasonableness."

Cross Reference: Sections 2-706, 7-403, 7-603 and Part 6 of Article 9.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Conspicuous". Section 1-201.
"Creditor". Section 1-201.
"Delivery". Section 1-201.
"Document of Title". Section 1-201.
"Good faith". Section 1-201 [7-102].
"Goods". Section 7-102.
"Notification". Section 1-202.
"Notifies". Section 1-202.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Rights". Section 1-201.
"Term". Section 1-201.
"Warehouse". Section 7-102.

ANNOTATION

For the liability of a warehouseman for failure to follow statutory procedures for enforcement of a lien under prior law, see Schmidt v. Cowan Transfer and Storage Co., 170 Colo. 550, 463 P.2d 445 (1970) (decided prior to the 2006 repeal and reenactment).

PART 3

BILLS OF LADING - SPECIAL PROVISIONS

4-7-301. Liability for nonreceipt or misdescription - "said to contain" - "shipper's weight, load, and count" - improper handling. (a) A consignee of a nonnegotiable bill of lading which has given value in good faith, or a holder to which a negotiable bill has been duly negotiated, relying upon the description of the goods in the bill or upon the date shown in the bill, may recover from the issuer damages caused by the misdating of the bill or the nonreceipt or misdescription of the goods, except to the extent that the bill indicates that the issuer does not know whether any part or all of the goods in fact were received or conform to the description, such as in a case in which the description is in terms of marks or labels or kind, quantity, or condition or the receipt or description is qualified by "contents or condition of contents of packages unknown", "said to contain", "shipper's weight, load, and count", or words of similar import, if that indication is true.

(b) If goods are loaded by the issuer of a bill of lading:

(1) The issuer shall count the packages of goods if shipped in packages and ascertain the kind and quantity if shipped in bulk; and

(2) Words such as "shipper's weight, load, and count" or words of similar import indicating that the description was made by the shipper are ineffective except as to goods concealed in packages.

(c) If bulk goods are loaded by a shipper that makes available to the issuer of a bill of lading adequate facilities for weighing those goods, the issuer shall ascertain the kind and quantity within a reasonable time after receiving the shipper's request in a record to do so. In that case, "shipper's weight" or words of similar import are ineffective.

(d) The issuer of a bill of lading, by including in the bill the words "shipper's weight, load, and count" or words of similar import, may indicate that the goods were loaded by the shipper, and, if that statement is true, the issuer is not liable for damages caused by the improper loading. However, omission of such words does not imply liability for damages caused by improper loading.

(e) A shipper guarantees to an issuer the accuracy at the time of shipment of the description, marks, labels, number, kind, quantity, condition, and weight, as furnished by

the shipper, and the shipper shall indemnify the issuer against damage caused by inaccuracies in those particulars. This right of indemnity does not limit the issuer's responsibility or liability under the contract of carriage to any person other than the shipper.

Source: L. 2006: Entire article R&RE, p. 478, § 2, effective September 1. **L. 2007:** Entire section amended, p. 368, § 11, effective August 3.

Editor's note: This section is similar to former § 4-7-301 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-301.

Changes: Changes for clarity, style and to recognize deregulation in the transportation industry.

Purposes:

1. This section continues the rules from former Section 7-301 with one substantive change. The obligations of the issuer of the bill of lading under former subsections (2) and (3) were limited to issuers who were common carriers. Subsections (b) and (c) apply the same rules to all issuers not just common carriers. This section is compatible with the policies stated in the federal Bills of Lading Act, 49 U.S.C. 80113 (2000).

2. The language of the pre-Code Uniform Bills of Lading Act suggested that a carrier is ordinarily liable for damage caused by improper loading, but may relieve itself of liability by disclosing on the bill that shipper actually loaded. A more accurate statement of the law is that the carrier is not liable for losses caused by act or default of the shipper, which would include improper loading. D.H. Overmyer Co. v. Nelson Brantler Glass Co., 168 S.E.2d 176 (Ga.Ct. App. 1969). There was some question whether under pre-Code law a carrier was liable even to a good faith purchaser of a negotiable bill for such losses, if the shipper's faulty loading in fact caused the loss. Subsection (d) permits the carrier to bar, by disclosure of shipper's loading, liability to a good faith purchaser. There is no implication that decisions such as Modern Tool Corp. v. Pennsylvania R. Co., 100 F.Supp. 595 (D.N.J.1951), are disapproved.

3. This section is a restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor or shipper. The wording in this section "contents or condition of contents of packages unknown" or "shipper's weight, load and count" to indicate that the shipper loaded the goods or that the carrier does not know the description, condition, or contents of the loaded packages continues to be appropriate as commonly understood in the transportation industry. The reasons for this wording are as important in 2002 as when the prior section initially was approved. The issuer is liable on documents issued by an agent, contrary to instructions of his principal, without receiving goods. No disclaimer of this liability is permitted since it is not a matter either of the care of the goods or their description.

4. The shipper's erroneous report to the carrier concerning the goods may cause damage to the carrier. Subsection (e) therefore provides appropriate indemnity.

5. The word "freight" in the former Section 7-301 has been changed to "goods" to conform to international and domestic land transport usage in which "freight" means the price paid for carriage of the goods and not the goods themselves. Hence, changing the word "freight" to the word "goods" is a clarifying change that fits both international and domestic practice.

Cross References: Sections 7-203, 7-309 and 7-501.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Consignee". Section 7-102.
"Document of Title". Section 1-201.
"Duly negotiate". Section 7-501.
"Good faith". Section 1-201 [7-102].
"Goods". Section 7-102.
"Holder". Section 1-201.
"Issuer". Section 7-102.
"Notice". Section 1-202.
"Party". Section 1-201.
"Purchaser". Section 1-201.
"Receipt of Goods". Section 2-103.
"Value". Section 1-204.

4-7-302. Through bills of lading and similar documents of title. (a) The issuer of a through bill of lading, or other document of title embodying an undertaking to be performed in part by a person acting as its agent or by a performing carrier, is liable to any person entitled to recover on the bill or other document for any breach by the other person or the performing carrier of its obligation under the bill or other document. However, to the extent that the bill or other document covers an undertaking to be performed overseas or in territory not contiguous to the continental United States or an undertaking including matters

other than transportation, this liability for breach by the other person or the performing carrier may be varied by agreement of the parties.

(b) If goods covered by a through bill of lading or other document of title embodying an undertaking to be performed in part by a person other than the issuer are received by that person, the person is subject, with respect to its own performance while the goods are in its possession, to the obligation of the issuer. The person's obligation is discharged by delivery of the goods to another person pursuant to the bill or other document and does not include liability for breach by any other person or by the issuer.

(c) The issuer of a through bill of lading or other document of title described in subsection (a) of this section is entitled to recover from the performing carrier, or other person in possession of the goods when the breach of the obligation under the bill or other document occurred:

(1) The amount it may be required to pay to any person entitled to recover on the bill or other document for the breach, as may be evidenced by any receipt, judgment, or transcript of judgment; and

(2) The amount of any expense reasonably incurred by the issuer in defending any action commenced by any person entitled to recover on the bill or other document for the breach.

Source: L. 2006: Entire article R&RE, p. 479, § 2, effective September 1. **L. 2007:** Entire section amended, p. 369, § 12, effective August 3.

Editor's note: This section is similar to former § 4-7-302 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-302.

Changes: To conform to current terminology and for style.

Purposes:

1. This section continues the rules from former Section 7-302 without substantive change. The term "performing carrier" is substituted for the term "connecting carrier" to conform the terminology of this section with terminology used in recent UNCITRAL and OAS proposals concerning transportation and through bills of lading. This change in terminology is not substantive. This section is compatible with liability on carriers under federal law. See 49 U.S.C. §§ 11706, 14706 and 15906.

The purpose of this section is to subject the initial carrier under a through bill to suit for breach of the contract of carriage by any performing carrier and to make it clear that any such performing carrier holds the goods on terms which are defined by the document of title even though such performing carrier did not issue the document. Since the performing carrier does hold the goods on the terms of the document, it must honor a proper demand for delivery or a diversion order just as the original bailee would have to. Similarly it has the benefits of the excuses for non-delivery and limitations of liability provided for the original bailee who issued the bill. Unlike the original bailee-issuer, the performing carrier's responsibility is limited to the period while the goods are in its possession. The section does not impose any obligation to issue through bills.

2. The reference to documents other than through bills looks to the possibility that multi-purpose documents may come into use, e.g., combination warehouse receipts and bills of lading. As electronic documents of title come into common usage, storage documents (e.g. warehouse receipts) and transportation documents (e.g. bills of lading) may merge seamlessly into one electronic document that can serve both the storage and transportation segments of the movement of goods.

3. Under subsection (a) the issuer of a through bill of lading may become liable for the fault of another person. Subsection (c) gives the issuer appropriate rights of recourse.

4. Despite the broad language of subsection (a), Section 7-302 is subject to preemption by federal laws and treaties. Section 7-103. The precise scope of federal preemption in the transportation sector is a question determined under federal law.

Cross reference: Section 7-103

Definitional Cross References:

"Agreement". Section 1-201.
"Bailee". Section 7-102.
"Bill of lading". Section 1-201.
"Delivery". Section 1-201.

"Document of title". Section 1-201.
"Goods". Section 7-102.
"Issuer". Section 7-102.
"Party". Section 1-201.
"Person". Section 1-201.

4-7-303. Diversion - reconsignment - change of instructions. (a) Unless the bill of lading otherwise provides, a carrier may deliver the goods to a person or destination other than that stated in the bill or may otherwise dispose of the goods, without liability for misdelivery, on instructions from:

(1) The holder of a negotiable bill;

(2) The consignor on a nonnegotiable bill, even if the consignee has given contrary instructions;

(3) The consignee on a nonnegotiable bill in the absence of contrary instructions from the consignor, if the goods have arrived at the billed destination or if the consignee is in possession of the tangible bill or in control of the electronic bill; or

(4) The consignee on a nonnegotiable bill, if the consignee is entitled as against the consignor to dispose of the goods.

(b) Unless instructions described in subsection (a) of this section are included in a negotiable bill of lading, a person to which the bill is duly negotiated may hold the bailee according to the original terms.

Source: L. 2006: Entire article R&RE, p. 480, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-303 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-303.

Changes: To accommodate electronic documents and for style.

Purposes:

1. Diversion is a very common commercial practice which defeats delivery to the consignee originally named in a bill of lading. This section continues former Section 7-303's safe harbor rules for carriers in situations involving diversion and adapts those rules to electronic documents of title. This section works compatibly with Section 2-705. Carriers may as a business matter be willing to accept instructions from consignees in which case the carrier will be liable for misdelivery if the consignee was not the owner or otherwise empowered to dispose of the goods under subsection (a)(4). The section imposes no duty on carriers to undertake diversion. The carrier is of course subject to the provisions of mandatory filed tariffs as provided in Section 7-103.

2. It should be noted that the section provides only an immunity for carriers against liability for "misdelivery." It does not, for example, defeat the title to the goods which the consignee-buyer may have acquired from the consignor-seller upon delivery of the goods to the carrier under a non- negotiable bill of lading. Thus if the carrier, upon instructions from the consignor, returns the goods to the cosignor, the consignee may recover the goods from the consignor or the cosignor's insolvent estate. However, under certain circumstances, the consignee's title may be defeated by diversion of the goods in transit to a different consignee. The rights that arise between the consignor-seller and the consignee-buyer out of a contract for the sale of goods are governed by Article 2.

Cross References:

Point 1: Sections 2-705 and 7-103.

Point 2: Article 2, Sections 7-403 and 7-504(3).

Definitional Cross References:

"Bailee". Section 7-102.
"Bill of lading". Section 1-201.
"Carrier". Section 7-102.
"Consignee". Section 7-102.
"Consignor". Section 7-102.
"Delivery". Section 1-201.
"Goods". Section 7-102.
"Holder". Section 1-201.
"Notice". Section 1-201.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Term". Section 1-201.

4-7-304. Tangible bills of lading in a set. (a) Except as customary in international transportation, a tangible bill of lading may not be issued in a set of parts. The issuer is liable for damages caused by violation of this subsection (a).

(b) If a tangible bill of lading is lawfully issued in a set of parts, each of which contains

an identification code and is expressed to be valid only if the goods have not been delivered against any other part, the whole of the parts constitutes one bill.

(c) If a tangible negotiable bill of lading is lawfully issued in a set of parts and different parts are negotiated to different persons, the title of the holder to which the first due negotiation is made prevails as to both the document of title and the goods even if any later holder may have received the goods from the carrier in good faith and discharged the carrier's obligation by surrendering its part.

(d) A person that negotiates or transfers a single part of a tangible bill of lading issued in a set is liable to holders of that part as if it were the whole set.

(e) The bailee shall deliver in accordance with part 4 of this article against the first presented part of a tangible bill of lading lawfully issued in a set. Delivery in this manner discharges the bailee's obligation on the whole bill.

Source: L. 2006: Entire article R&RE, p. 480, § 2, effective September 1. **L. 2007:** (e) amended, p. 370, § 13, effective August 3.

Editor's note: This section is similar to former § 4-7-304 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-304.

Changes: To limit bills in a set to tangible bills of lading and to use terminology more consistent with modern usage.

Purposes:

1. Tangible bills of lading in a set are still used in some nations in international trade. Consequently, a tangible bill of lading part of a set could be at issue in a lawsuit that might come within Article 7. The statement of the legal effect of a lawfully issued set is in accord with existing commercial law relating to maritime and other international tangible bills of lading. This law has been codified in the Hague and Warsaw Conventions and in the Carriage of Goods by Sea Act, the provisions of which would ordinarily govern in situations where bills in a set are recognized by this Article. Tangible bills of lading in a set are prohibited in domestic trade.

2. Electronic bills of lading in domestic or international trade will not be issued in a set given the requirements of control necessary to deliver the bill to another person. An electronic bill of lading will be a single, authoritative copy. Section 7-106. Hence, this section differentiates between electronic bills of lading and tangible bills of lading. This section does not prohibit electronic data messages about goods in transit because these electronic data messages are not the issued bill of lading. Electronic data messages contain information for the carrier's management and handling of the cargo but this information for the carrier's use is not the issued bill of lading.

Cross Reference: Section 7-103, 7-303 and 7-106.

Definitional Cross References:

"Bailee". Section 7-102.
"Bill of lading". Section 1-201.
"Delivery". Section 1-201.
"Document of Title". Section 1-201.
"Duly negotiate". Section 7-501.
"Good faith". Section 1-201. [7-102].
"Goods". Section 7-102.
"Holder". Section 1-201.
"Issuer". Section 7-102.
"Person". Section 1-201.
"Receipt of goods". Section 2-103.

4-7-305. Destination bills. (a) Instead of issuing a bill of lading to the consignor at the place of shipment, a carrier, at the request of the consignor, may procure the bill to be issued at destination or at any other place designated in the request.

(b) Upon request of any person entitled as against a carrier to control the goods while in transit and on surrender of possession or control of any outstanding bill of lading or other receipt covering the goods, the issuer, subject to section 4-7-105, may procure a substitute bill to be issued at any place designated in the request.

Source: L. 2006: Entire article R&RE, p. 481, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-305 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-305.
Changes: To accommodate electronic bills of lading and for style.
Purposes:
1. Subsection (a) continues the rules of former Section 7-305(1) without substantive change. This proposal is designed to facilitate the use of order bills in connection with fast shipments. Use of order bills on high speed shipments is impeded by the fact that the goods may arrive at destination before the documents, so that no one is ready to take delivery from the carrier. This is especially inconvenient for carriers by truck and air, who do not have terminal facilities where shipments can be held to await the consignee's appearance. Order bills would be useful to take advantage of bank collection. This may be preferable to C.O.D. shipment in which the carrier, e.g. a truck driver, is the collecting and remitting agent. Financing of shipments under this plan would be handled as follows: seller at San Francisco delivers the goods to an airline with instructions to issue a bill in New York to a named bank. Seller receives a receipt embodying this undertaking to issue a destination bill. Airline wires its New York freight agent to issue the bill as instructed by the seller. Seller wires the New York bank a draft on buyer. New York bank indorses the bill to buyer when the buyer honors the draft. Normally seller would act through its own bank in San Francisco, which would extend credit in reliance on the airline's contract to deliver a bill to the order of its New York correspondent. This section is entirely permissive; it imposes no duty to issue such bills. Whether a performing carrier will act as issuing agent is left to agreement between carriers.
2. Subsection (b) continues the rule from former Section 7-305(2) with accommodation for electronic bills of lading. If the substitute bill changes from an electronic to a tangible medium or vice versa, the issuance of the substitute bill must comply with Section 7-105 to give the substitute bill validity and effect.
Cross Reference: Section 7-105.
Definitional Cross References:
"Bill of lading". Section 1-201.
"Consignor". Section 7-102.
"Goods". Section 7-102.
"Issuer". Section 7-102.
"Receipt of goods". Section 2-103.

4-7-306. Altered bills of lading. An unauthorized alteration or filling in of a blank in a bill of lading leaves the bill enforceable according to its original tenor.

Source: L. 2006: Entire article R&RE, p. 481, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-306 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-306.
Changes: None
Purposes:
An unauthorized alteration or filling in of a blank, whether made with or without fraudulent intent, does not relieve the issuer of its liability on the document as originally executed. This section applies to both tangible and electronic bills of lading, applying the same rule to both types of bills of lading. The control concept of Section 7-106 requires that any changes to the electronic document of title be readily identifiable as authorized or unauthorized. Section 7-306 should be compared to Section 7-208 where a different rule applies to the unauthorized filling in of a blank for tangible warehouse receipts.
Cross Reference: Sections 7-106 and 7-208.
Definitional Cross References:
"Bill of lading". Section 1-201.
"Issuer". Section 7-102.

4-7-307. Lien of carrier. (a) A carrier has a lien on the goods covered by a bill of lading or on the proceeds thereof in its possession for charges after the date of the carrier's receipt of the goods for storage or transportation, including demurrage and terminal charges, and for expenses necessary for preservation of the goods incident to their transportation or reasonably incurred in their sale pursuant to law. However, against a purchaser for value of a negotiable bill of lading, a carrier's lien is limited to charges stated in the bill or the applicable tariffs or, if no charges are stated, a reasonable charge.

(b) A lien for charges and expenses under subsection (a) of this section on goods that the carrier was required by law to receive for transportation is effective against the consignor or any person entitled to the goods unless the carrier had notice that the consignor lacked authority to subject the goods to those charges and expenses. Any other lien under subsection (a) of this section is effective against the consignor and any person that permitted the bailor to have control or possession of the goods unless the carrier had notice that the bailor lacked authority.

(c) A carrier loses its lien on any goods that it voluntarily delivers or unjustifiably refuses to deliver.

(d) A mover, as defined in section 40-10.1-101, C.R.S., that does not have a current and valid permit issued under part 5 of article 10.1 of title 40, C.R.S., does not have a lien under this section. A mover that acquires a lien under this section and whose permit lapses or is revoked during the pendency of the lien loses its lien.

Source: L. 2006: Entire article R&RE, p. 481, § 2, effective September 1. **L. 2007:** (d) added, p. 1919, § 7, effective July 1. **L. 2011:** (d) amended, (HB 11-1198), ch. 127, p. 416, § 4, effective August 10.

Editor's note: This section is similar to former § 4-7-307 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-307.

Changes: Expanded to cover proceeds of the goods transported.

Purposes:

1. The section is intended to give carriers a specific statutory lien for charges and expenses similar to that given to warehouses by the first sentence of Section 7-209(a) and extends that lien to the proceeds of the goods as long as the carrier has possession of the proceeds. But because carriers do not commonly claim a lien for charges in relation to other goods or lend money on the security of goods in their hands, provisions for a general lien or a security interest similar to those in Section 7-209(a) and (b) are omitted. Carriers may utilize Article 9 to obtain a security interest and become a secured party or a carrier may agree to limit its lien rights in a transportation agreement with the shipper. As the lien given by this section is specific, and the storage or transportation often preserves or increases the value of the goods, subsection (b) validates the lien against anyone who permitted the bailor to have possession of the goods. Where the carrier is required to receive the goods for transportation, the owner's interest may be subjected to charges and expenses arising out of deposit of his goods by a thief. The crucial mental element is the carrier's knowledge or reason to know of the bailor's lack of authority. If the carrier does not know or have reason to know of the bailor's lack of authority, the carrier has a lien under this section against any person so long as the conditions of subsection (b) are satisfied. In light of the crucial mental element, Sections 7-307 and 9-333 combine to give priority to a carrier's lien over security interests in the goods. In this regard, the judicial decision in In re Sharon Steel Corp., 25 U.C.C. Rep.2d 503, 176 B.R. 384 (W.D. Pa. 1995) is correct and is the controlling precedent.

2. The reference to charges in this section means charges relating to the bailment relationship for transportation. Charges does not mean that the bill of lading must state a specific rate or a specific amount. However, failure to state a specific rate or a specific amount has legal consequences under the second sentence of subsection (a).

3. The carrier's specific lien under this section is a possessory lien. See subsection (c). Part 3 of Article 7 does not require any particular form for a bill of lading. The carrier's lien arises when the carrier has issued a bill of lading.

Cross References:

Point 1: Sections 7-209, 9-109 and 9-333.

Point 3. Section 7-202 and 7-209.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Carrier". Section 7-102.
"Consignor". Section 7-102.
"Delivery". Section 1-201.
"Goods". Section 7-102.
"Person". Section 1-201.
"Purchaser". Section 1-201.
"Value". Section 1-204.

ANNOTATION

Applied in Resort Graphics v. Rio Grande Motor Way, 707 P.2d 1011 (Colo. App. 1985), rev'd on other grounds, 740 P.2d 517 (Colo. 1987) (decided prior to the 2006 repeal and reenactment).

4-7-308. Enforcement of carrier's lien. (a) A carrier's lien on goods may be enforced by public or private sale of the goods, in bulk or in packages, at any time or place and on any terms that are commercially reasonable, after notifying all persons known to claim an interest in the goods. The notification must include a statement of the amount due, the nature of the proposed sale, and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a method different from that selected by the carrier is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. The carrier sells goods in a commercially reasonable manner if the carrier sells the goods in the usual manner in any recognized market therefor, sells at the price current in that market at the time of the sale, or otherwise sells in conformity with commercially reasonable practices among dealers in the type of goods sold. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable, except in cases covered by the preceding sentence.

(b) Before any sale is held pursuant to this section, any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred in complying with this section. In that event, the goods may not be sold but must be retained by the carrier, subject to the terms of the bill of lading and this article.

(c) A carrier may buy at any public sale pursuant to this section.

(d) A purchaser in good faith of goods sold to enforce a carrier's lien takes the goods free of any rights of persons against which the lien was valid, despite the carrier's noncompliance with this section.

(e) A carrier may satisfy its lien from the proceeds of any sale pursuant to this section but shall hold the balance, if any, for delivery on demand to any person to which the carrier would have been bound to deliver the goods.

(f) The rights provided by this section are in addition to all other rights allowed by law to a creditor against a debtor.

(g) A carrier's lien may be enforced pursuant to either subsection (a) of this section or the procedure set forth in section 4-7-210 (b).

(h) A carrier is liable for damages caused by failure to comply with the requirements for sale under this section and, in case of willful violation, is liable for conversion.

Source: L. 2006: Entire article R&RE, p. 482, § 2, effective September 1. **L. 2007:** (a) amended, p. 370, § 14, effective August 3.

Editor's note: This section is similar to former § 4-7-308 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-308.

Changes: To conform language to modern usage and for style.

Purposes:

This section is intended to give the carrier an enforcement procedure of its lien coextensive with that given the warehouse in cases other than those covering noncommercial storage by the warehouse. See Section 7-210 and comments.

Cross Reference: Section 7-210.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Carrier". Section 7-102.
"Creditor". Section 1-201.
"Delivery". Section 1-201.
"Good faith". Section 1-201. [7-102]
"Goods". Section 7-102.
"Notification". Section 1-202.
"Notifies". Section 1-202.
"Person". Section 1-201.

"Purchaser". Section 1-201.
"Rights". Section 1-201.
"Term". Section 1-201.

4-7-309. Duty of care - contractual limitation of carrier's liability. (a) A carrier that issues a bill of lading, whether negotiable or nonnegotiable, shall exercise the degree of care in relation to the goods which a reasonably careful person would exercise under similar circumstances. This subsection (a) does not affect any statute, regulation, or rule of law that imposes liability upon a common carrier for damages not caused by its negligence.

(b) Damages may be limited by a term in the bill of lading that the carrier's liability may not exceed a value stated in the bill if the carrier's rates are dependent upon value and the consignor is afforded an opportunity to declare a higher value and the consignor is advised of the opportunity. However, such a limitation is not effective with respect to the carrier's liability for conversion to its own use.

(c) Reasonable provisions as to the time and manner of presenting claims and commencing actions based on the shipment may be included in a bill of lading.

Source: L. 2006: Entire article R&RE, p. 482, § 2, effective September 1. **L. 2007:** (a) and (b) amended, p. 370, § 15, effective August 3.

Editor's note: This section is similar to former § 4-7-309 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-309.

Changes: References to tariffs eliminated because of deregulation, adding reference to transportation agreements, and for style.

Purposes:

1. A bill of lading may also serve as the contract between the carrier and the bailor. Parties in their contract should be able to limit the amount of damages for breach of that contract including breach of the duty to take reasonable care of the goods. The parties cannot disclaim by contract the carrier's obligation of care. Section 1-302.

Federal statutes and treaties for air, maritime and rail transport may alter the standard of care. These federal statutes and treaties preempt this section when applicable. Section 7-103. Subsection (a) does not impair any rule of law imposing the liability of an insurer on a common carrier in intrastate commerce. Subsection (b), however, applies to the common carrier's liability as an insurer as well as to liability based on negligence. Subsection (b) allows the term limiting damages to appear either in the bill of lading or in the parties' transportation agreement. Compare 7-204(b). Subsection (c) allows the parties to agree to provisions regarding time and manner of presenting claims or commencing actions if the provisions are either in the bill of lading or the transportation agreement. Compare 7-204(c). Transportation agreements are commonly used to establish agreed terms between carriers and shippers that have an ongoing relationship.

2. References to public tariffs in former Section 7-309(2) and (3) have been deleted in light of the modern era of deregulation. See Comment 2 to Section 7-103. If a tariff is required under state or federal law, pursuant to Section 7-103(a), the tariff would control over the rule of this section. As governed by contract law, parties may incorporate by reference the limits on the amount of damages or the reasonable provisions as to the time and manner of presenting claims set forth in applicable tariffs, e.g. a maximum unit value beyond which goods are not taken or a disclaimer of responsibility for undeclared articles of extraordinary value.

3. As under former Section 7-309(2), subsection (b) provides that a limitation of damages is ineffective if the carrier has converted the goods to its own use. A mere failure to redeliver the goods is not conversion to the carrier's own use. "Conversion to its own use" is narrower than the idea of conversion generally. Art Masters Associates, Ltd. v. United Parcel Service, 77 N.Y. 2d 200, 567 N.E. 2d 226 (1990); *See*, Kemper Ins. Co. v. Fed. Ex. Corp., 252 F.3d 509 (1st Cir), *cert. denied* 534 U.S. 1020 (2001) (opinion interpreting federal law).

4. As used in this section, damages may include damages arising from delay in delivery. Delivery dates and times are often specified in the parties' contract. See Section 7-403.

Cross Reference: Sections 1-302, 7-103, 7-204, 7-403.

Definitional Cross References:

"Action". Section 1-201.
"Bill of lading". Section 1-201.

"Carrier". Section 7-102.
"Consignor". Section 7-102.
"Document of Title". Section 1-201.
"Goods". Section 7-102.
"Value". Section 1-204.

PART 4

WAREHOUSE RECEIPTS AND BILLS OF LADING - GENERAL OBLIGATIONS

4-7-401. Irregularities in issue of receipt or bill or conduct of issuer. The obligations imposed by this article on an issuer apply to a document of title even if:

(1) The document does not comply with the requirements of this article or of any other statute, rule, or regulation regarding its issuance, form, or content;

(2) The issuer violated laws regulating the conduct of its business;

(3) The goods covered by the document were owned by the bailee when the document was issued; or

(4) The person issuing the document is not a warehouse but the document purports to be a warehouse receipt.

Source: L. 2006: Entire article R&RE, p. 483, § 2, effective September 1. **L. 2007:** (1) amended, p. 371, § 16, effective August 3.

Editor's note: This section is similar to former § 4-7-401 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-401.
Changes: Changes for style only.
Purposes:
The bailee's liability on its document despite non-receipt or misdescription of the goods is affirmed in Sections 7-203 and 7-301. The purpose of this section is to make it clear that regardless of irregularities a document which falls within the definition of document of title imposes on the issuer the obligations stated in this Article. For example, a bailee will not be permitted to avoid its obligation to deliver the goods (Section 7-403) or its obligation of due care with respect to them (Sections 7-204 and 7-309) by taking the position that no valid "document" was issued because it failed to file a statutory bond or did not pay stamp taxes or did not disclose the place of storage in the document. Tate v. Action Moving & Storage, Inc., 383 S.E.2d 229 (N.C. App. 1989), *rev. denied* 389 S.E.2d 104 (N.C. 1990). Sanctions against violations of statutory or administrative duties with respect to documents should be limited to revocation of license or other measures prescribed by the regulation imposing the duty. See Sections 7-103.
Cross References: Sections 7-103, 7-203, 7-204, 7-301, 7-309.
Definitional Cross References:
"Bailee". Section 7-102.
"Document of title". Section 1-201.
"Goods". Section 7-102.
"Issuer". Section 7-102.
"Person". Section 1-201.
"Warehouse receipt". Section 1-201.
"Warehouse". Section 7-102.

4-7-402. Duplicate document of title - overissue. A duplicate or any other document of title purporting to cover goods already represented by an outstanding document of the same issuer does not confer any right in the goods, except as provided in the case of tangible bills of lading in a set of parts, overissue of documents for fungible goods, substitutes for lost, stolen, or destroyed documents, or substitute documents issued pursuant to section 4-7-105. The issuer is liable for damages caused by its overissue or failure to identify a duplicate document by a conspicuous notation.

Source: L. 2006: Entire article R&RE, p. 483, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-402 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-402.
Changes: Changes to accommodate electronic documents.
Purposes:

1. This section treats a duplicate which is not properly identified as a duplicate like any other overissue of documents: a purchaser of such a document acquires no title but only a cause of action for damages against the person that made the deception possible, except in the cases noted in the section. But parts of a tangible bill lawfully issued in a set of parts are not "overissue" (Section 7-304). Of course, if the issuer has clearly indicated that a document is a duplicate so that no one can be deceived by it, and in fact the duplicate is a correct copy of the original, the issuer is not liable for preparing and delivering such a duplicate copy.

Section 7-105 allows documents of title to be reissued in another medium. Re-issuance of a document in an alternative medium under Section 7-105 requires that the original document be surrendered to the issuer in order to make the substitute document the effective document. If the substitute document is not issued in compliance with section 7-105, then the document should be treated as a duplicate under this section.

2. The section applies to nonnegotiable documents to the extent of providing an action for damages for one who acquires an unmarked duplicate from a transferor who knew the facts and would therefore have had no cause of action against the issuer of the duplicate. Ordinarily the transferee of a nonnegotiable document acquires only the rights of its transferor.

3. Overissue is defined so as to exclude the common situation where two valid documents of different issuers are outstanding for the same goods at the same time. Thus freight forwarders commonly issue bills of lading to their customers for small shipments to be combined into carload shipments for which the railroad will issue a bill of lading to the forwarder. So also a warehouse receipt may be outstanding against goods, and the holder of the receipt may issue delivery orders against the same goods. In these cases dealings with the subsequently issued documents may be effective to transfer title; e.g. negotiation of a delivery order will effectively transfer title in the ordinary case where no dishonesty has occurred and the goods are available to satisfy the orders. Section 7-503 provides for cases of conflict between documents of different issuers.

Cross References:

Point 1: Sections 7-105, 7-207, 7-304, and 7-601.

Point 3: Section 7-503.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Conspicuous". Section 1-201.
"Document of title". Section 1-201.
"Fungible" goods. Section 1-201.
"Goods". Section 7-102.
"Issuer". Section 7-102.
"Right". Section 1-201.

4-7-403. Obligation of bailee to deliver - excuse. (a) A bailee shall deliver the goods to a person entitled under a document of title if the person complies with subsections (b) and (c) of this section, unless and to the extent that the bailee establishes any of the following:

(1) Delivery of the goods to a person whose receipt was rightful as against the claimant;

(2) Damage to or delay, loss, or destruction of the goods for which the bailee is not liable;

(3) Previous sale or other disposition of the goods in lawful enforcement of a lien or on a warehouse's lawful termination of storage;

(4) The exercise by a seller of its right to stop delivery pursuant to section 4-2-705 or by a lessor of its right to stop delivery pursuant to section 4-2.5-526;

(5) A diversion, reconsignment, or other disposition pursuant to section 4-7-303;

(6) Release, satisfaction, or any other personal defense against the claimant; or

(7) Any other lawful excuse.

(b) A person claiming goods covered by a document of title shall satisfy the bailee's lien if the bailee so requests or if the bailee is prohibited by law from delivering the goods until the charges are paid.

(c) Unless a person claiming the goods is a person against which the document of title does not confer a right under section 4-7-503 (a):

(1) The person claiming under a document shall surrender possession or control of any outstanding negotiable document covering the goods for cancellation or indication of partial deliveries; and

(2) The bailee shall cancel the document or conspicuously indicate in the document the partial delivery or the bailee is liable to any person to which the document is duly negotiated.

Source: L. 2006: Entire article R&RE, p. 483, § 2, effective September 1. **L. 2007:** IP(a), (a)(6), (b), IP(c), and (c)(2) amended, p. 371, § 17, effective August 3.

Editor's note: This section is similar to former § 4-7-403 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-403.

Changes: Definition in former Section 7-403(4) moved to Section 7-102; bracketed language in former Section 7-403(1)(b) deleted; added cross reference to Section 2A-526; changes for style.

Purposes:

1. The present section, following former Section 7-403, is constructed on the basis of stating what previous deliveries or other circumstances operate to excuse the bailee's normal obligation on the document. Accordingly, "justified" deliveries under the pre-Code uniform acts now find their place as "excuse" under subsection (a).

2. The principal case covered by subsection (a)(1) is delivery to a person whose title is paramount to the rights represented by the document. For example, if a thief deposits stolen goods in a warehouse facility and takes a negotiable receipt, the warehouse is not liable on the receipt if it has surrendered the goods to the true owner, even though the receipt is held by a good faith purchaser. See Section 7-503(a). However, if the owner entrusted the goods to a person with power of disposition, and that person deposited the goods and took a negotiable document, the owner's receiving delivery would not be rightful as against a holder to whom the negotiable document was duly negotiated, and delivery to the owner would not give the bailee a defense against such a holder. See Sections 7-502(a)(2), 7-503(a)(1).

3. Subsection (a)(2) amounts to a cross reference to all the tort law that determines the varying responsibilities and standards of care applicable to commercial bailees. A restatement of this tort law would be beyond the scope of this Act. Much of the applicable law as to responsibility of bailees for the preservation of the goods and limitation of liability in case of loss has been codified for particular classes of bailees in interstate and foreign commerce by federal legislation and treaty and for intrastate carriers and other bailees by the regulatory state laws preserved by Section 7-103. In the absence of governing legislation the common law will prevail subject to the minimum standard of reasonable care prescribed by Sections 7-204 and 7-309 of this Article.

The bracketed language found in former Section 7-403(1)(b) has been deleted thereby leaving the allocations of the burden of going forward with the evidence and the burden of proof to the procedural law of the various states.

Subsection (a)(4) contains a cross reference to both the seller's and the lessor's rights to stop delivery under Article 2 and Article 2A respectively.

4. As under former Section 7-403, there is no requirement that a request for delivery must be accompanied by a formal tender of the amount of the charges due. Rather, the bailee must request payment of the amount of its lien when asked to deliver, and only in case this request is refused is it justified in declining to deliver because of nonpayment of charges. Where delivery without payment is forbidden by law, the request is treated as implicit. Such a prohibition reflects a policy of uniformity to prevent discrimination by failure to request payment in particular cases. Subsection (b) must be read in conjunction with the priorities given to the warehouse lien and the carrier lien under Section 7-209 and 7-307, respectively. If the parties are in dispute about whether the request for payment of the lien is legally proper, the bailee may have recourse to interpleader. See Section 7-603.

5. Subsection (c) states the obvious duty of a bailee to take up a negotiable document or note partial deliveries conspicuously thereon, and the result of failure in that duty. It is subject to only one exception, that stated in subsection (a)(1) of this section and in Section 7-503(a). Subsection (c) is limited to cases of delivery to a claimant; it has no application, for example, where goods held under a negotiable document are lawfully sold to enforce the bailee's lien.

6. When courts are considering subsection (a)(7), "any other lawful excuse," among others, refers to compliance with court orders under Sections 7-601, 7-602 and 7-603.

Cross References:

Point 2: Sections 7-502 and 7-503.

Point 3: Sections 2-705, 2A-526, 7-103, 7-204, and 7-309 and 10-103.

Point 4: Sections 7-209, 7-307 and 7-603.

Point 5: Section 7-503(1).

Point 6: Sections 7-601, 7-602, and 7-603.

Definitional Cross References:

"Bailee". Section 7-102.

"Conspicuous". Section 1-201.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Duly negotiate". Section 7-501.

"Goods". Section 7-102.

"Lessor". Section 2A-103.

"Person". Section 1-201.

"Receipt of goods". Section 2-103.

"Right". Section 1-201.
"Terms". Section 1-201.
"Warehouse". Section 7-102.

ANNOTATION

Release of goods to dealer as defense. In action for conversion of goods stored by plaintiff with named defendant, if the plaintiff either instructed defendant to receive and store the goods for a dealer or delivered them under such circumstances as to give defendant reasonable ground to believe that plaintiff intended that the goods be held for the dealer, and defendant released said goods to the dealer, in good faith, without knowledge or information that plaintiff intended to hold the goods until payment by dealer, such constitutes a defense to plaintiff's action; but defendant warehouseman, having admitted the receipt of goods from plaintiff in the usual course of its warehouse business, the burden of going forward with the evidence is on defendant to justify delivery to one other than plaintiff. Wheelock Bros. v. Bankers Whse. Co., 115 Colo. 197, 171 P.2d 405 (1946) (decided under repealed CSA, C. 173, § 8, uniform warehouse receipts act).

4-7-404. No liability for good-faith delivery pursuant to document of title. A bailee that in good faith has received goods and delivered or otherwise disposed of the goods according to the terms of a document of title or pursuant to this article is not liable for the goods even if:

(1) The person from which the bailee received the goods did not have authority to procure the document or to dispose of the goods; or

(2) The person to which the bailee delivered the goods did not have authority to receive the goods.

Source: L. 2006: Entire article R&RE, p. 484, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-404 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-404.
Changes: Changes reflect the definition of good faith in Section 1-201 [7-102] and for style.
Purposes:
This section uses the test of good faith, as defined in Section 1-201 [7-102], to continue the policy of former Section 7-404. Good faith now means "honesty in fact and the observance of reasonable commercial standards of fair dealing." The section states explicitly that the common law rule of "innocent conversion" by unauthorized "intermeddling" with another's property is inapplicable to the operations of commercial carriers and warehousemen that in good faith perform obligations that they have assumed and that generally they are under a legal compulsion to assume. The section applies to delivery to a fraudulent holder of a valid document as well as to delivery to the holder of an invalid document. Of course, in appropriate circumstances, a bailee may use interpleader or other dispute resolution process. See Section 7-603.
Cross Reference: Section 7-603.
Definitional Cross References:
"Bailee". Section 7-102.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Good faith". Section 1-201 [7-102].
"Goods". Section 7-102.
"Person". Section 1-201.
"Receipt of goods". Section 2-103.
"Term". Section 1-201.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

PART 5

WAREHOUSE RECEIPTS AND BILLS OF LADING
- NEGOTIATION AND TRANSFER

4-7-501. Form of negotiation and requirements of due negotiation. (a) The following rules apply to a negotiable tangible document of title:

(1) If the document's original terms run to the order of a named person, the document is negotiated by the named person's indorsement and delivery. After the named person's indorsement in blank or to bearer, any person may negotiate the document by delivery alone.

(2) If the document's original terms run to bearer, it is negotiated by delivery alone.

(3) If the document's original terms run to the order of a named person and it is delivered to the named person, the effect is the same as if the document had been negotiated.

(4) Negotiation of the document after it has been indorsed to a named person requires indorsement by the named person and delivery.

(5) A document is duly negotiated if it is negotiated in the manner stated in this subsection (a) to a holder that purchases it in good faith, without notice of any defense against or claim to it on the part of any person, and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a monetary obligation.

(b) The following rules apply to a negotiable electronic document of title:

(1) If the document's original terms run to the order of a named person or to bearer, the document is negotiated by delivery of the document to another person. Indorsement by the named person is not required to negotiate the document.

(2) If the document's original terms run to the order of a named person and the named person has control of the document, the effect is the same as if the document had been negotiated.

(3) A document is duly negotiated if it is negotiated in the manner stated in this subsection (b) to a holder that purchases it in good faith, without notice of any defense against or claim to it on the part of any person, and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves taking delivery of the document in settlement or payment of a monetary obligation.

(c) Indorsement of a nonnegotiable document of title neither makes it negotiable nor adds to the transferee's rights.

(d) The naming in a negotiable bill of lading of a person to be notified of the arrival of the goods does not limit the negotiability of the bill or constitute notice to a purchaser of the bill of any interest of that person in the goods.

Source: L. 2006: Entire article R&RE, p. 485, § 2, effective September 1. **L. 2007:** (a)(4) amended, p. 371, § 18, effective August 3.

Editor's note: This section is similar to former § 4-7-501 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-501.

Changes: To accommodate negotiable electronic documents of title.

Purpose:

1. Subsection (a) has been limited to tangible negotiable documents of title but otherwise remains unchanged in substance from the rules in former Section 7-501. Subsection (b) is new and applies to negotiable electronic documents of title. Delivery of a negotiable electronic document is through voluntary transfer of control. Section 1-201 definition of "delivery." The control concept as applied to negotiable electronic documents of title is the substitute for both possession and indorsement as applied to negotiable tangible documents of title. Section 7-106.

Article 7 does not separately define the term "duly negotiated." However, the elements of "duly negotiated" are set forth in subsection (a)(5) and (b)(3) for electronic documents. As under former Section 7-501, in order to effect a "due negotiation" the negotiation must be in the "regular course of business or financing" in

order to transfer greater rights than those held by the person negotiating. The foundation of the mercantile doctrine of good faith purchase for value has always been, as shown by the case situations, the furtherance and protection of the regular course of trade. The reason for allowing a person, in bad faith or in error, to convey away rights which are not its own has from the beginning been to make possible the speedy handling of that great run of commercial transactions which are patently usual and normal.

There are two aspects to the usual and normal course of mercantile dealings, namely, the person making the transfer and the nature of the transaction itself. The first question which arises is: Is the transferor a person with whom it is reasonable to deal as having full powers? In regard to documents of title the only holder whose possession or control appears, commercially, to be in order is almost invariably a person in the trade. No commercial purpose is served by allowing a tramp or a professor to "duly negotiate" an order bill of lading for hides or cotton not their own, and since such a transfer is obviously not in the regular course of business, it is excluded from the scope of the protection of subsections (a)(5) or (b)(3).

The second question posed by the "regular course" qualification is: Is the transaction one which is normally proper to pass full rights without inquiry, even though the transferor itself may not have such rights to pass, and even though the transferor may be acting in breach of duty? In raising this question the "regular course" criterion has the further advantage of limiting, the effective wrongful disposition to transactions whose protection will really further trade. Obviously, the snapping up of goods for quick resale at a price suspiciously below the market deserves no protection as a matter of policy: it is also clearly outside the range of regular course.

Any notice on the document sufficient to put a merchant on inquiry as to the "regular course" quality of the transaction will frustrate a "due negotiation". Thus irregularity of the document or unexplained staleness of a bill of lading may appropriately be recognized as negating a negotiation in "regular" course.

A pre-existing claim constitutes value, and "due negotiation" does not require "new value." A usual and ordinary transaction in which documents are received as security for credit previously extended may be in "regular" course, even though there is a demand for additional collateral because the creditor "deems himself insecure." But the matter has moved out of the regular course of financing if the debtor is thought to be insolvent, the credit previously extended is in effect cancelled, and the creditor snatches a plank in the shipwreck under the guise of a demand for additional collateral. Where a money debt is "paid" in commodity paper, any question of "regular" course disappears, as the case is explicitly excepted from "due negotiation".

2. Negotiation under this section may be made by any holder no matter how the holder acquired possession or control of the document.

3. Subsections (a)(3) and (b)(2) make explicit a matter upon which the intent of the pre-Code law was clear but the language somewhat obscure: a negotiation results from a delivery to a banker or buyer to whose order the document has been taken by the person making the bailment. There is no presumption of irregularity in such a negotiation; it may very well be in "regular course."

4. This Article does not contain any provision creating a presumption of due negotiation to, and full rights in, a holder of a document of title akin to that created by Uniform Commercial Code Article 3. But the reason of the provisions of this Act (Section 1-307) on the prima facie authenticity and accuracy of third party documents, joins with the reason of the present section to work such a presumption in favor of any person who has power to make a due negotiation. It would not make sense for this Act to authorize a purchaser to indulge the presumption of regularity if the courts were not also called upon to do so. Allocations of the burden of going forward with the evidence and the burden of proof are left to the procedural law fo the various states.

5. Subsections (c) and (d) are unchanged from prior law and apply to both tangible and electronic documents of title.

Cross References: Sections 1-307, 7-502 and 7-503.

Definitional Cross References:

"Bearer". Section 1-201.
"Control". Section 7-106.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Good faith". Section 1-201 [7-102].
"Holder". Section 1-201.
"Notice". Section 1-202.
"Person". Section 1-201.
"Purchase". Section 1-201.
"Rights". Section 1-201.
"Term". Section 1-201.
"Value". Section 1-204.

4-7-502. Rights acquired by due negotiation. (a) Subject to sections 4-7-205 and 4-7-503, a holder to which a negotiable document of title has been duly negotiated acquires thereby:

(1) Title to the document;

(2) Title to the goods;

(3) All rights accruing under the law of agency or estoppel, including rights to goods delivered to the bailee after the document was issued; and

(4) The direct obligation of the issuer to hold or deliver the goods according to the terms of the document free of any defense or claim by the issuer except those arising under the terms of the document or under this article, but in the case of a delivery order, the bailee's obligation accrues only upon the bailee's acceptance of the delivery order and the obligation acquired by the holder is that the issuer and any indorser will procure the acceptance of the bailee.

(b) Subject to section 4-7-503, title and rights acquired by due negotiation are not defeated by any stoppage of the goods represented by the document of title or by surrender of the goods by the bailee and are not impaired even if:

(1) The due negotiation or any prior due negotiation constituted a breach of duty;

(2) Any person has been deprived of possession of a negotiable tangible document or control of a negotiable electronic document by misrepresentation, fraud, accident, mistake, duress, loss, theft, or conversion; or

(3) A previous sale or other transfer of the goods or document has been made to a third person.

Source: L. 2006: Entire article R&RE, p. 486, § 2, effective September 1. **L. 2007:** (a)(4) amended, p. 372, § 19, effective August 3.

Editor's note: This section is similar to former § 4-7-502 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-502.

Changes: To accommodate electronic documents of title and for style.

Purpose:

1. This section applies to both tangible and electronic documents of title. The elements of duly negotiated, which constitutes a due negotiation, are set forth in Section 7-501. The several necessary qualifications of the broad principle that the holder of a document acquired in a due negotiation is the owner of the document and the goods have been brought together in the next section. (Section 7-503).

2. Subsection (a)(3) covers the case of "feeding" of a duly negotiated document by subsequent delivery to the bailee of such goods as the document falsely purported to cover; the bailee in such case is estopped as against the holder of the document.

3. The explicit statement in subsection (a)(4) of the bailee's direct obligation to the holder precludes the defense that the document in question was "spent" after the carrier had delivered the goods to a previous holder. But the holder is subject to such defenses as non-negligent destruction even though not apparent on the document. The sentence on delivery orders applies only to delivery orders in negotiable form which have been duly negotiated. On delivery orders, see also Section 7-503(b) and Comment.

4. Subsection (b) continues the law which gave full effect to the issuance or due negotiation of a negotiable document. The subsection adds nothing to the effect of the rules stated in subsection (a), but it has been included since such explicit reference was provided under former Section 7-502 to preserve the right of a purchaser by due negotiation. The listing is not exhaustive. The language"any stoppage" is included lest an inference be drawn that a stoppage of the goods before or after transit might cut off or otherwise impair the purchaser's rights.

Cross References: Sections 7-103, 7-205, 7-403, 7-501, and 7-503.

Definitional Cross References:

"Bailee". Section 7-102.
"Delivery". Section 1-201.
"Delivery order". Section 7-102.
"Document of title". Section 1-201.
"Duly negotiate". Section 7-501.
"Fungible". Section 1-201.
"Goods". Section 7-102.
"Holder". Section 1-201.
"Issuer". Section 7-102.
"Person". Section 1-201.
"Rights". Section 1-201.
"Term". Section 1-201.
"Warehouse receipt". Section 1-201.

4-7-503. Document of title to goods defeated in certain cases. (a) A document of title confers no right in goods against a person that before issuance of the document had a legal interest or a perfected security interest in the goods and that did not:

(1) Deliver or entrust the goods or any document of title covering the goods to the bailor or the bailor's nominee with:

(A) Actual or apparent authority to ship, store, or sell;

(B) Power to obtain delivery under section 4-7-403; or

(C) Power of disposition under section 4-2-403, 4-2.5-304 (2), 4-2.5-305 (2), 4-9-320, or 4-9-321 (c) or other statute or rule of law; or

(2) Acquiesce in the procurement by the bailor or its nominee of any document.

(b) Title to goods based upon an unaccepted delivery order is subject to the rights of any person to which a negotiable warehouse receipt or bill of lading covering the goods has been duly negotiated. That title may be defeated under section 4-7-504 to the same extent as the rights of the issuer or a transferee from the issuer.

(c) Title to goods based upon a bill of lading issued to a freight forwarder is subject to the rights of any person to which a bill issued by the freight forwarder is duly negotiated. However, delivery by the carrier in accordance with part 4 of this article pursuant to its own bill of lading discharges the carrier's obligation to deliver.

Source: L. 2006: Entire article R&RE, p. 486, § 2, effective September 1. **L. 2007:** (a)(1) amended, p. 372, § 20, effective August 3.

Editor's note: This section is similar to former § 4-7-503 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-503.

Changes: Changes to cross-reference to Article 2A and for style.

Purposes:

1. In general it may be said that the title of a purchaser by due negotiation prevails over almost any interest in the goods which existed prior to the procurement of the document of title if the possession of the goods by the person obtaining the document derived from any action by the prior claimant which introduced the goods into the stream of commerce or carried them along that stream. A thief of the goods cannot indeed by shipping or storing them to the thief's own order acquire power to transfer them to a good faith purchaser. Nor can a tenant or mortgagor defeat any rights of a landlord or mortgagee which have been perfected under the local law merely by wrongfully shipping or storing a portion of the crop or other goods. However, "acquiescence" by the landlord or mortgagee does not require active consent under subsection (a)(2) and knowledge of the likelihood of storage or shipment with no objection or effort to control it is sufficient to defeat the landlord's or the mortgagee's rights as against one who takes by due negotiation of a negotiable document. In re Sharon Steel, 176 B.R. 384 (Bankr. W.D. Pa. 1995); In re R.V. Segars Co, 54 B.R. 170 (Bankr. S.C. 1985); In re Jamestown Elevators, Inc. 49 B.R. 661 (Bankr. N.D. 1985).

On the other hand, where goods are delivered to a factor for sale, even though the factor has made no advances and is limited in its duty to sell for cash, the goods are "entrusted" to the factor "with actual . . . authority . . . to sell" under subsection (a)(1), and if the factor procures a negotiable document of title it can transfer the owner's interest to a purchaser by due negotiation. Further, where the factor is in the business of selling, goods entrusted to it simply for safekeeping or storage may be entrusted under circumstances which give the factor "apparent authority to ship, store or sell" under subsection (a)(1), or power of disposition under Section 2-403, 2A-304(2), 2A-305(2), 7-205, 9-320 or 9-321 (c), or under a statute such as the earlier Factors Acts, or under a rule of law giving effect to apparent ownership. See Section 1-103.

Persons having an interest in goods also frequently deliver or entrust them to agents or servants other than factors for the purpose of shipping or warehousing or under circumstances reasonably contemplating such action. This Act is clear that such persons assume full risk that the agent to whom the goods are so delivered may ship or store in breach of duty, take a document to the agent's own order and then proceed to misappropriate the negotiable document of title that embodies the goods. This Act makes no distinction between possession or mere custody in such situations and finds no exception in the case of larceny by a bailee or the like. The safeguard in such situations lies in the requirement that a due negotiation can occur only "in the regular course of business or financing" and that the purchase be in good faith and without notice. See Section 7-501. Documents of title have no market among the commercially inexperienced and the commercially experienced do not take them without inquiry from persons known to be truck drivers or petty

clerks even though such persons purport to be operating in their own names.

Again, where the seller allows a buyer to receive goods under a contract for sale, though as a "conditional delivery" or under "cash sale" terms and on explicit agreement for immediate payment, the buyer thereby acquires power to defeat the seller's interest by transfer of the goods to certain good faith purchasers. See Section 2-403. Both in policy and under the language of subsection (a)(1) that same power must be extended to accomplish the same result if the buyer procures a negotiable document of title to the goods and duly negotiates it.

This comment 1 should be considered in interpreting delivery, entrustment or acquiescence in application of Section 7-209 (c).

2. Under subsection (a) a delivery order issued by a person having no right in or power over the goods is ineffective unless the owner acts as provided in subsection (a)(1) or (2). Thus the rights of a transferee of a non-negotiable warehouse receipt can be defeated by a delivery order subsequently issued by the transferor only if the transferee "delivers or entrusts" to the "person procuring" the delivery order or "acquiesces" in that person's procurement. Similarly, a second delivery order issued by the same issuer for the same goods will ordinarily be subject to the first, both under this section and under Section 7-402. After a delivery order is validly issued but before it is accepted, it may nevertheless be defeated under subsection (b) in much the same way that the rights of a transferee may be defeated under Section 7-504. For example, a buyer in ordinary course from the issuer may defeat the rights of the holder of a prior delivery order if the bailee receives notification of the buyer's rights before notification of the holder's rights. Section 7-504(b)(2). But an accepted delivery order has the same effect as a document issued by the bailee.

3. Under subsection (c) a bill of lading issued to a freight forwarder is subordinated to the freight forwarder's document of title, since the bill on its face gives notice of the fact that a freight forwarder is in the picture and the freight forwarder has in all probability issued a document of title. But the carrier is protected in following the terms of its own bill of lading.

Cross References:

Point 1: Sections 1-103, 2-403, 2A-304(2), 2A-305(2), 7-205, 7-209, 7-501, 9-320, 9-321(c), and 9-331.

Point 2: Sections 7-402 and 7-504.

Point 3: Sections 7-402, 7-403 and 7-404.

Definitional Cross References:

"Bill of lading". Section 1-201.
"Contract for sale". Section 2-106.
"Delivery". Section 1-201.
"Delivery order". Section 7-102.
"Document of title". Section 1-201.
"Duly negotiate". Section 7-501.
"Goods". Section 7-102.
"Person". Section 1-201.
"Right". Section 1-201.
"Warehouse receipt". Section 1-201.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

4-7-504. Rights acquired in absence of due negotiation - effect of diversion - stoppage of delivery. (a) A transferee of a document of title, whether negotiable or nonnegotiable, to which the document has been delivered but not duly negotiated, acquires the title and rights that its transferor had or had actual authority to convey.

(b) In the case of a transfer of a nonnegotiable document of title, until but not after the bailee receives notice of the transfer, the rights of the transferee may be defeated:

(1) By those creditors of the transferor which could treat the transfer as void under section 4-2-402 or 4-2.5-308;

(2) By a buyer from the transferor in ordinary course of business if the bailee has delivered the goods to the buyer or received notification of the buyer's rights;

(3) By a lessee from the transferor in ordinary course of business if the bailee has delivered the goods to the lessee or received notification of the lessee's rights; or

(4) As against the bailee, by good-faith dealings of the bailee with the transferor.

(c) A diversion or other change of shipping instructions by the consignor in a nonnegotiable bill of lading which causes the bailee not to deliver the goods to the consignee defeats the consignee's title to the goods if the goods have been delivered to a buyer in ordinary course of business or a lessee in ordinary course of business and, in any event, defeats the consignee's rights against the bailee.

(d) Delivery of the goods pursuant to a nonnegotiable document of title may be stopped by a seller under section 4-2-705 or a lessor under section 4-2.5-526, subject to the

requirements of due notification in those sections. A bailee that honors the seller's or lessor's instructions is entitled to be indemnified by the seller or lessor against any resulting loss or expense.

Source: L. 2006: Entire article R&RE, p. 487, § 2, effective September 1. **L. 2007:** IP(b), (b)(1), (c), and (d) amended, p. 372, § 21, effective August 3.

Editor's note: This section is similar to former § 4-7-504 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-504.

Changes: To include cross-references to Article 2A and for style.

Purposes:

1. Under the general principles controlling negotiable documents, it is clear that in the absence of due negotiation a transferor cannot convey greater rights than the transferor has, even when the negotiation is formally perfect. This section recognizes the transferor's power to transfer rights which the transferor has or has "actual authority to convey." Thus, where a negotiable document of title is being transferred the operation of the principle of estoppel is not recognized, as contrasted with situations involving the transfer of the goods themselves. (Compare Section 2-403 on good faith purchase of goods.) This section applies to both tangible and electronic documents of title.

A necessary part of the price for the protection of regular dealings with negotiable documents of title is an insistence that no dealing which is in any way irregular shall be recognized as a good faith purchase of the document or of any rights pertaining to it. So, where the transfer of a negotiable document fails as a negotiation because a requisite indorsement is forged or otherwise missing, the purchaser in good faith and for value may be in the anomalous position of having less rights, in part, than if the purchaser had purchased the goods themselves. True, the purchaser's rights are not subject to defeat by attachment of the goods or surrender of them to the purchaser's transferor (contrast subsection (b)); but on the other hand, the purchaser cannot acquire enforceable rights to control or receive the goods over the bailee's objection merely by giving notice to the bailee. Similarly, a consignee who makes payment to its consignor against a straight bill of lading can thereby acquire the position of a good faith purchaser of goods under provisions of the Article of this Act on Sales (Section 2-403), whereas the same payment made in good faith against an unendorsed order bill would not have such effect. The appropriate remedy of a purchaser in such a situation is to regularize its status by compelling indorsement of the document (see Section 7-506).

2. As in the case of transfer—as opposed to "due negotiation"—of negotiable documents, subsection (a) empowers the transferor of a nonnegotiable document to transfer only such rights as the transferor has or has "actual authority" to convey. In contrast to situations involving the goods themselves the operation of estoppel or agency principles is not here recognized to enable the transferor to convey greater rights than the transferor actually has. Subsection (b) makes it clear, however, that the transferee of a nonnegotiable document may acquire rights greater in some respects than those of his transferor by giving notice of the transfer to the bailee. New subsection (b)(3) provides for the rights of a lessee in the ordinary course.

Subsection (b)(2)&(3) require delivery of the goods. Delivery of the goods means the voluntary transfer of physical possession of the goods. See amended 2-103.

3. Subsection (c) is in part a reiteration of the carrier's immunity from liability if it honors instructions of the consignor to divert, but there is added a provision protecting the title of the substituted consignee if the latter is a buyer in ordinary course of business. A typical situation would be where a manufacturer, having shipped a lot of standardized goods to A on nonnegotiable bill of lading, diverts the goods to customer B who pays for them. Under pre-Code passage-of-title-by-appropriation doctrine A might reclaim the goods from B. However, no consideration of commercial policy supports this involvement of an innocent third party in the default of the manufacturer on his contract to A; and the common commercial practice of diverting goods in transit suggests a trade understanding in accordance with this subsection. The same result should obtain if the substituted consignee is a lessee in ordinary course. The extent of the lessee's interest in the goods is less than a buyer's interest in the goods. However, as against the first consignee and the lessee in ordinary course as the substituted consignee, the lessee's rights in the goods as granted under the lease are superior to the first consignee's rights.

4. Subsection (d) gives the carrier an express right to indemnity where the carrier honors a seller's request to stop delivery.

5. Section 1-202 gives the bailee protection, if due diligence is exercised where the bailee's

organization has not had time to act on a notification.
Cross References:
Point 1: Sections 2-403 and 7-506.
Point 2: Sections 2-403 and 2A-304.
Point 3: Sections 7-303, 7-403(a)(5) and 7-404.
Point 4: Sections 2-705 and 7-403(a)(4).
Point 5: Section 1-202.
Definitional Cross References:
"Bailee". Section 7-102.
"Bill of lading". Section 1-201.
"Buyer in ordinary course of business". Section 1-201.
"Consignee". Section 7-102.
"Consignor". Section 7-102.
"Creditor". Section 1-201.
"Delivery". Section 1-201.
"Document of Title". Section 1-201.
"Duly negotiate". Section 7-501.
"Good faith". Section 1-201. [7-102].
"Goods". Section 7-102.
"Honor". Section 1-201.
"Lessee in ordinary course". Section 2A-103.
"Notification". Section 1-202.
"Purchaser". Section 1-201.
"Rights". Section 1-201.

4-7-505. Indorser not guarantor for other parties. The indorsement of a tangible document of title issued by a bailee does not make the indorser liable for any default by the bailee or previous indorsers.

Source: L. 2006: Entire article R&RE, p. 487, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-505 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-505.
Changes: Limited to tangible documents of title.
Purposes:
This section is limited to tangible documents of title as the concept of indorsement is irrelevant to electronic documents of title. Electronic documents of title will be transferred by delivery of control. Section 7-106. The indorsement of a tangible document of title is generally understood to be directed towards perfecting the transferee's rights rather than towards assuming additional obligations. The language of the present section, however, does not preclude the one case in which an indorsement given for value guarantees future action, namely, that in which the bailee has not yet become liable upon the document at the time of the indorsement. Under such circumstances the indorser, of course, engages that appropriate honor of the document by the bailee will occur. See Section 7-502(a)(4) as to negotiable delivery orders. However, even in such a case, once the bailee attorns to the transferee, the indorser's obligation has been fulfilled and the policy of this section excludes any continuing obligation on the part of the indorser for the bailee's ultimate actual performance.
Cross Reference: Sections 7-106 and 7-502.
Definitional Cross References:
"Bailee". Section 7-102.
"Document of title". Section 1-201.
"Party". Section 1-201.

4-7-506. Delivery without indorsement - right to compel indorsement. The transferee of a negotiable tangible document of title has a specifically enforceable right to have its transferor supply any necessary indorsement, but the transfer becomes a negotiation only as of the time the indorsement is supplied.

Source: L. 2006: Entire article R&RE, p. 488, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-506 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-506.
Changes: Limited to tangible documents of title.
Purposes:
1. This section is limited to tangible documents of title as the concept of indorsement is irrelevant to electronic documents of title. Elec-

tronic documents of title will be transferred by delivery of control. Section 7-106. From a commercial point of view the intention to transfer a tangible negotiable document of title which requires an indorsement for its transfer, is incompatible with an intention to withhold such indorsement and so defeat the effective use of the document. Further, the preceding section and the Comment thereto make it clear that an indorsement generally imposes no responsibility on the indorser.

2. Although this section provides that delivery of a tangible document of title without the necessary indorsement is effective as a transfer, the transferee, of course, has not regularized its position until such indorsement is supplied. Until this is done the transferee cannot claim rights under due negotiation within the requirements of this Article (Section 7-501(a)(5)) on "due negotiation". Similarly, despite the transfer to the transferee of the transferor's title, the transferee cannot demand the goods from the bailee until the negotiation has been completed and the document is in proper form for surrender. See Section 7-403(c).

Cross References:

Point 1: Sections 7-106 and 7-505.

Point 2: Sections 7-501(a)(5) and 7-403(c).

Definitional Cross References:

"Document of title". Section 1-201.

"Rights". Section 1-201.

4-7-507. Warranties on negotiation or delivery of document of title. If a person negotiates or delivers a document of title for value, otherwise than as a mere intermediary under section 4-7-508, unless otherwise agreed, the transferor, in addition to any warranty made in selling or leasing the goods, warrants to its immediate purchaser only that:

(1) The document is genuine;

(2) The transferor does not have knowledge of any fact that would impair the document's validity or worth; and

(3) The negotiation or delivery is rightful and fully effective with respect to the title to the document and the goods it represents.

Source: L. 2006: Entire article R&RE, p. 488, § 2, effective September 1. **L. 2007:** IP amended, p. 373, § 22, effective August 3.

Editor's note: This section is similar to former § 4-7-507 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-507.

Changes: Substitution of the word "delivery" for the word "transfer," reference leasing transactions and style.

Purposes:

1. Delivery of goods by use of a document of title does not limit or displace the ordinary obligations of a seller or lessor as to any warranties regarding the goods that arises under other law. If the transfer of documents attends or follows the making of a contract for the sale or lease of goods, the general obligations on warranties as to the goods (Sections 2-312 through 2-318 and Sections 2A-210 through 2A-316) are brought to bear as well as the special warranties under this section.

2. The limited warranties of a delivering or collecting intermediary, including a collecting bank, are stated in Section 7-508.

Cross References:

Point 1: Sections 2-312 through 2-318 and 2A-310-through 2A-316.

Point 2: Section 7-508.

Definitional Cross References:

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Genuine". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Value". Section 1-204.

4-7-508. Warranties of collecting bank as to documents of title. A collecting bank or other intermediary known to be entrusted with documents of title on behalf of another or with collection of a draft or other claim against delivery of documents warrants by the delivery of the documents only its own good faith and authority even if the collecting bank or other intermediary has purchased or made advances against the claim or draft to be collected.

Source: L. 2006: Entire article R&RE, p. 488, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-508 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-508.
Changes: Changes for style only.
Purposes:
1. To state the limited warranties given with respect to the documents accompanying a documentary draft.
2. In warranting its authority a collecting bank or other intermediary only warrants its authority from its transferor. See Section 4-203. It does not warrant the genuineness or effectiveness of the document. Compare Section 7-507.
3. Other duties and rights of banks handling documentary drafts for collection are stated in Article 4, Part 5. On the meaning of draft, see Section 4-104 and Section 5-102, comment 11.

Cross References:
Sections 4-104, 4-203, 4-501 through 4-504, 5-1023, and 7-507.
Definitional Cross References:
"Collecting bank". Section 4-105.
"Delivery". Section 1-201.
"Document of title". Section 1-102.
"Documentary draft". Section 4-104.
"Intermediary bank". Section 4-105.
"Good faith". Section 1-201 [7-102.]

4-7-509. Adequate compliance with commercial contract. Whether a document of title is adequate to fulfill the obligations of a contract for sale, a contract for lease, or the conditions of a letter of credit is determined by article 2, 2.5, or 5 of this title.

Source: L. 2006: Entire article R&RE, p. 488, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-509 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-509.
Changes: To reference Article 2A.
Purposes:
To cross-refer to the Articles of this Act which deal with the substantive issues of the type of document of title required under the contract entered into by the parties.

Cross References: Articles 2, 2A and 5.
Definitional Cross References:
"Contract for sale". Section 2-106.
"Document of title". Section 1-201.
"Lease". Section 2A-103.

PART 6

WAREHOUSE RECEIPTS AND BILLS OF LADING - MISCELLANEOUS PROVISIONS

4-7-601. Lost, stolen, or destroyed documents of title. (a) If a document of title is lost, stolen, or destroyed, a court may order delivery of the goods or issuance of a substitute document and the bailee may without liability to any person comply with the order. If the document was negotiable, a court may not order delivery of the goods or issuance of a substitute document without the claimant's posting security unless it finds that any person that may suffer loss as a result of nonsurrender of possession or control of the document is adequately protected against the loss. If the document was nonnegotiable, the court may require security. The court may also order payment of the bailee's reasonable costs and attorney's fees in any action under this subsection (a).

(b) A bailee that, without a court order, delivers goods to a person claiming under a missing negotiable document of title is liable to any person injured thereby. If the delivery is not in good faith, the bailee is liable for conversion. Delivery in good faith is not conversion if the claimant posts security with the bailee in an amount at least double the value of the goods at the time of posting to indemnify any person that is injured by the delivery and that files a notice of claim within one year after the delivery.

Source: L. 2006: Entire article R&RE, p. 488, § 2, effective September 1. **L. 2007:** Entire section amended, p. 373, § 23, effective August 3.

Editor's note: This section is similar to former § 4-7-601 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provision: Former Section 7-601.

Changes: To accommodate electronic documents; to provide flexibility to courts similar to the flexibility in Section 3-309; to update to the modern era of deregulation; and for style.

Purposes:

1. Subsection (a) authorizes courts to order compulsory delivery of the goods or compulsory issuance of a substitute document. Compare Section 7-402. Using language similar to that found in Section 3-309, courts are given discretion as to what is adequate protection when the lost, stolen or destroyed document was negotiable or whether security should be required when the lost, stolen or destroyed document was non-negotiable. In determining whether a party is adequately protected against loss in the case of a negotiable document, the court should consider the likelihood that the party will suffer a loss. The court is also given discretion as to the bailee's costs and attorney fees. The rights and obligations of a bailee under this section depend upon whether the document of title is lost, stolen or destroyed and is in addition to the ability of the bailee to bring an action for interpleader. See Section 7-603.

2. Courts have the authority under this section to order a substitute document for either tangible or electronic documents. If the substitute document will be in a different medium than the original document, the court should fashion its order in light of the requirements of Section 7-105.

3. Subsection (b) follows prior Section 7-601 in recognizing the legality of the well established commercial practice of bailees making delivery in good faith when they are satisfied that the claimant is the person entitled under a missing (i.e. lost , stolen, or destroyed) negotiable document. Acting without a court order, the bailee remains liable on the original negotiable document and, to avoid conversion liability, the bailee may insist that the claimant provide an indemnity bond. Cf. Section 7-403.

4. Claimants on non-negotiable instruments are permitted to avail themselves of the subsection (a) procedure because straight (non-negotiable) bills of lading sometimes contain provisions that the goods shall not be delivered except upon production of the bill. If the carrier should choose to insist upon production of the bill, the consignee should have some means of compelling delivery on satisfactory proof of entitlement. Without a court order, a bailee may deliver, subject to Section 7-403, to a person claiming goods under a non- negotiable document that the same person claims is lost, stolen, or destroyed.

5. The bailee's lien should be protected when a court orders delivery of the goods pursuant to this section.

Cross References:

Point 1: Sections 3-309, 7-402 and 7-603.
Point 2: Section 7-105.
Point 3: Section 7-403.
Point 4: Section 7-403.
Point 5: Sections 7-209 and 7-307.

Definitional Cross References:

"Bailee". Section 7-102.
"Delivery". Section 1-201.
"Document of Title". Section 1-201.
"Good faith". Section 1-201 [7-102].
"Goods". Section 7-102.
"Person". Section 1-201.

4-7-602. Attachment of goods covered by negotiable document of title. Unless a document of title was originally issued upon delivery of the goods by a person that did not have power to dispose of them, a lien does not attach by virtue of any judicial process to goods in the possession of a bailee for which a negotiable document of title is outstanding unless possession or control of the document is first surrendered to the bailee or the document's negotiation is enjoined. The bailee may not be compelled to deliver the goods pursuant to process until possession or control of the document is surrendered to the bailee or to the court. A purchaser of the document for value without notice of the process or injunction takes free of the lien imposed by judicial process.

Source: L. 2006: Entire article R&RE, p. 489, § 2, effective September 1. **L. 2007:** Entire section amended, p. 373, § 24, effective August 3.

Editor's note: This section is similar to former § 4-7-602 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provisions: Former Section 7-602.
Changes: Changes to accommodate electronic documents of title and for style.
Purposes:
1. The purpose of the section is to protect the bailee from conflicting claims of the document of title holder and the judgment creditors of the person who deposited the goods. The rights of the former prevail unless, in effect, the judgment creditors immobilize the negotiable document of title through the surrender of possession of a tangible document or control of an electronic document. However, if the document of title was issued upon deposit of the goods by a person who had no power to dispose of the goods so that the document is ineffective to pass title, judgment liens are valid to the extent of the debtor's interest in the goods.
2. The last sentence covers the possibility that the holder of a document who has been enjoined from negotiating it will violate the injunction by negotiating to an innocent purchaser for value. In such case the lien will be defeated.

Cross Reference:
Sections 7-106 and 7-501 through 7-503.

Definitional Cross References:
"Bailee". Section 7-102.
"Delivery". Section 1-201.
"Document of title". Section 1-201.
"Goods". Section 7-102.
"Notice". Section 1-202.
"Person". Section 1-201.
"Purchase". Section 1-201.
"Value". Section 1-204.

4-7-603. Conflicting claims - interpleader. If more than one person claims title to or possession of the goods, the bailee is excused from delivery until the bailee has a reasonable time to ascertain the validity of the adverse claims or to commence an action for interpleader. The bailee may assert an interpleader either in defending an action for nondelivery of the goods or by original action.

Source: L. 2006: Entire article R&RE, p. 489, § 2, effective September 1.

Editor's note: This section is similar to former § 4-7-603 as it existed prior to 2006.

OFFICIAL COMMENT

Prior Uniform Statutory Provisions: Former Section 7-603.
Changes: Changes for style only.
Purposes:
1. The section enables a bailee faced with conflicting claims to the goods to compel the claimants to litigate their claims with each other rather than with the bailee. The bailee is protected from legal liability when the bailee complies with court orders from the interpleader. See e.g. Northwestern National Sales, Inc. v. Commercial Cold Storage, Inc., 162 Ga.App. 741, 293 S.E.2d. 30 (1982).
2. This section allows the bailee to bring an interpleader action but does not provide an exclusive basis for allowing interpleader. If either state or federal procedural rules allow an interpleader in other situations, the bailee may commence an interpleader under those rules. Even in an interpleader to which this section applies, the state or federal process of interpleader applies to the bailee's action for interpleader. For example, state or federal interpleader statutes or rules may permit a bailee to protect its lien or to seek attorney's fees and costs in the interpleader action.

Cross reference:
Point 1: Section 7-403.

Definitional Cross References:
"Action". Section 1-201.
"Bailee". Section 7-102.
"Delivery". Section 1-201.
"Goods". Section 7-102.
"Person". Section 1-201.
"Reasonable time". Section 1-205.

ANNOTATION

Annotator's note. Since § 4-7-603 is similar to repealed § 146-2-11, CRS 53, uniform warehouse receipts act, a relevant case construing that provision, CRS 53 has been included in the annotations to this section.

The intent of this section is to protect warehousemen from situations whereby they would be required to determine adverse claims at their peril. Petzoldt v. Lawrence Whse. Co., 157 F. Supp. 184 (D. Colo. 1957), aff'd sub nom. First

Nat'l Bank v. Petzoldt, 262 F.2d 540 (10th Cir. 1958).

Where adverse claims are made on a warehouseman for goods and their possession, then, under this section the warehouseman is under no duty to deliver to either claimant until the lapse of reasonable time. Petzoldt v. Lawrence Whse. Co., 157 F. Supp. 184 (D. Colo. 1957), aff'd sub nom. First Nat'l Bank v. Petzoldt, 262 F.2d 540 (10th Cir. 1958).

Its sole duty, after demand is made, is either to compel interpleader or to make reasonable efforts to investigate the validity of the adverse claims. Petzoldt v. Lawrence Whse. Co., 157 F. Supp. 184 (D. Colo. 1957), aff'd sub nom. First Nat'l Bank v. Petzoldt, 262 F.2d 540 (10th Cir. 1958).

Where before the warehouseman has time to determine the claims or to interplead the claimants, the goods are replevied, and therefore, are no longer under the warehouseman's control, then for subsequent nondelivery, when it is no longer in its power to do so, the warehouseman cannot be under any liability. Petzoldt v. Lawrence Whse. Co., 157 F. Supp. 184 (D. Colo. 1957), aff'd sub nom. First Nat'l Bank v. Petzoldt, 262 F.2d 540 (10th Cir. 1958).

A warehouseman may excuse his failure to deliver property by showing that it has been taken under judicial process, and that he gave due notice to the depositor, or made reasonable efforts to do so. Petzoldt v. Lawrence Whse. Co., 157 F. Supp. 184 (D. Colo. 1957), aff'd sub nom. First Nat'l Bank v. Pelzoldt, 262 F.2d 540 (10th Cir. 1958).

A warehouseman is not the guarantor of title to goods for which he gave a receipt and is not liable for failure of the title thereunder. Petzoldt v. Lawrence Whse. Co., 157 F. Supp. 184 (D. Colo. 1957), aff'd sub nom. First Nat'l Bank v. Petzoldt, 262 F.2d 540 (10th Cir. 1958).

PART 7

TRANSITION PROVISIONS

4-7-701. Effective date. This article shall take effect on September 1, 2006.

Source: L. 2006: Entire article R&RE, p. 489, § 2, effective September 1.

4-7-702. Applicability. This article applies to a document of title that is issued or a bailment that arises on or after September 1, 2006. This article does not apply to a document of title that is issued or a bailment that arises before September 1, 2006, even if the document of title or bailment would be subject to this article if the document of title had been issued or bailment had arisen on or after September 1, 2006. This article does not apply to a right of action that has accrued before September 1, 2006.

Source: L. 2006: Entire article R&RE, p. 489, § 2, effective September 1. **L. 2007:** Entire section amended, p. 373, § 25, effective August 3.

OFFICIAL COMMENT

This Act will apply prospectively only to documents of title issued or bailments that arise after the effective date of the Act.

4-7-703. Savings clause. A document of title issued or a bailment that arises before September 1, 2006, and the rights, obligations, and interests flowing from that document or bailment are governed by any statute or other rule amended or repealed by this article as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute or other rule.

Source: L. 2006: Entire article R&RE, p. 489, § 2, effective September 1.

OFFICIAL COMMENT

This Act will apply prospectively only to documents of title issued or bailments that arise after the effective date of the Act. To the extent that issues arise based upon documents of title

or rights or obligations that arise prior to the effective date of this Act, prior law will apply to resolve those issues.

ARTICLE 8

Investment Securities

Editor's note: (1) The numbering and sequencing of C.R.S. subsections do not necessarily correspond with the numbering and sequencing of subsections in the uniform act.

(2) This article was numbered as article 8 of chapter 155, C.R.S. 1963. The provisions of this article were repealed and reenacted in 1996, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 1996, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated. For a detailed comparison, see the "Table of Disposition of Sections in Prior Versions" in the prefatory note at the beginning of this article.

Law reviews: For article, "Limited Partnership Interests as Uncertificated Securities", see 13 Colo. Law. 1194 (1984).

PART 1

SHORT TITLE AND GENERAL MATTERS

PART 2

ISSUE AND ISSUER

PART 3

TRANSFER OF CERTIFICATED AND UNCERTIFICATED SECURITIES

PART 4

REGISTRATION

ARTICLE 8. INVESTMENT SECURITIES
PREFATORY NOTE

The present version of Article 8 is the product of a major revision made necessary by the fact that the prior version of Article 8 did not adequately deal with the system of securities holding through securities intermediaries that has developed in the past few decades. Although the prior version of Article 8 did contain some provisions dealing with securities holding through securities intermediaries, these were engrafted onto a structure designed for securities practices of earlier times. The resulting legal uncertainties adversely affected all participants. The revision is intended to eliminate these uncertainties by providing a modern legal structure for current securities holding practices.

I. EVOLUTION OF SECURITIES HOLDING SYSTEMS

A. The Traditional Securities Holding System

The original version of Article 8, drafted in the 1940s and 1950s, was based on the assumption that possession and delivery of physical certificates are the key elements in the securities holding system. Ownership of securities was traditionally evidenced by possession of the certificates, and changes were accomplished by delivery of the certificates.

Transfer of securities in the traditional certificate-based system was a complicated, labor-intensive process. Each time securities were traded, the physical certificates had to be delivered from the seller to the buyer, and in the case of registered securities the certificates had to be surrendered to the issuer or its transfer agent for registration of transfer. As is well known, the mechanical problems of processing the paperwork for securities transfers reached crisis proportions in the late 1960s, leading to calls for the elimination of the physical certificate and development of modern electronic systems for recording ownership of securities and transfers of ownership. That was the focus of the revision effort that led to the promulgation of the 1978 amendments to Article 8 concerning uncertificated securities.

B. The Uncertificated Securities System Envisioned by the 1978 Amendments

In 1978, amendments to Article 8 were approved to establish the commercial law rules that were thought necessary to permit the evolution of a system in which issuers would no longer issue certificates. The Drafting Committee that produced the 1978 amendments was given a fairly limited charge. It was to draft the

revisions that would be needed for uncertificated securities, but otherwise leave the Article 8 rules unchanged. Accordingly, the 1978 amendments primarily took the form of adding parallel provisions dealing with uncertificated securities to the existing rules of Article 8 on certificated securities.

The system of securities holding contemplated by the 1978 amendments differed from the traditional system only in that ownership of securities would not be evidenced by physical certificates. It was contemplated that changes in ownership would continue to be reflected by changes in the records of the issuer. The main difference would be that instead of surrendering an indorsed certificate for registration of transfer, an instruction would be sent to the issuer directing it to register the transfer. Although a system of the sort contemplated by the 1978 amendments may well develop in the coming decades, this has not yet happened for most categories of securities. Mutual funds shares have long been issued in uncertificated form, but virtually all other forms of publicly traded corporate securities are still issued in certificated form. Individual investors who wish to be recorded as registered owners on the issuers' books still obtain and hold physical certificates. The certificates representing the largest portion of the shares of publicly traded companies, however, are not held by the beneficial owners, but by clearing corporations. Settlement of securities trading occurs not by delivery of certificates or by registration of transfer on the records of the issuers or their transfer agents, but by computer entries in the records of clearing corporations and securities intermediaries. That is quite different from the system envisioned by the 1978 amendments.

C. Evolution of the Indirect Holding System

At the time of the "paperwork crunch" in the late 1960s, the trading volume on the New York Stock Exchange that so seriously strained the capacities of the clearance and settlement system was in the range of 10 million shares per day. Today, the system can easily handle trading volume on routine days of hundreds of millions of shares. This processing capacity could have been achieved only by the application of modern electronic information processing systems. Yet the legal rules under which the system operates are not the uncertificated securities provisions of Article 8. To understand why this is so, one must delve at least a bit deeper into the operations of the current system.

If one examines the shareholder records of large corporations whose shares are publicly traded on the exchanges or in the over the counter market, one would find that one entity — Cede & Co. — is listed as the shareholder of record of somewhere in the range of sixty to eighty per cent of the outstanding shares of all publicly traded companies. Cede & Co. is the nominee name used by The Depository Trust Company ("DTC"), a limited purpose trust company organized under New York law for the purpose of acting as a depository to hold securities for the benefit of its participants, some 600 or so broker-dealers and banks. Essentially all of the trading in publicly held companies is executed through the broker-dealers who are participants in DTC, and the great bulk of public securities — the sixty to eighty per cent figure noted above — are held by these broker-dealers and banks on behalf of their customers. If all of these broker-dealers and banks held physical certificates, then as trades were executed each day it would be necessary to deliver the certificates back and forth among these broker-dealers and banks. By handing all of their securities over to a common depository all of these deliveries can be eliminated. Transfers can be accomplished by adjustments to the participants' DTC accounts.

Although the use of a common depository eliminates the needs for physical deliveries, an enormous number of entries would still have to be made on DTC's books if each transaction between its participants were recorded one by one on DTC's books. Any two major broker-dealers may have executed numerous trades with each other in a given security on a single day. Significant processing efficiency has been achieved by netting all of the transactions among the participants that occur each day, so that entries need be made on the depository's books only for the net changes in the positions of each participant at the end of each day. This clearance and netting function might well be performed by the securities exchanges or by the same institution that acts as the depository, as is the case in many other securities markets around the world. In the United States, however, this clearance and netting function is carried out by a separate corporation, National Securities Clearing Corporation ("NSCC"). All that needs to be done to settle each day's trading is for NSCC to compute the net receive and deliver obligations and to instruct DTC to make the corresponding adjustments in the participants' accounts.

The broker-dealers and banks who are participants in the DTC-NSCC system in turn provide analogous clearance and settlement functions to their own customers. If Customer A buys 100 shares of XYZ Co. through Broker, and Customer B sells 100 shares of XYZ Co. through the same Broker, the trade can be settled by entries on Broker's books. Neither DTC's books showing Broker's total position in XYZ Co., nor XYZ Co.'s books showing DTC's total position in XYZ Co., need be changed to reflect the settlement of this trade. One can readily appreciate the significance of the settlement function performed at this level if one considers that a

single major bank may be acting as securities custodian for hundreds or thousands of mutual funds, pension funds, and other institutional investors. On any given day, the customers of that bank may have entered into an enormous number of trades, yet it is possible that relatively little of this trading activity will result in any net change in the custodian bank's positions on the books of DTC.

Settlement of market trading in most of the major U.S. securities markets is now effected primarily through some form of netted clearance and depository system. Virtually all publicly traded corporate equity securities, corporate debt securities, and municipal debt securities are now eligible for deposit in the DTC system. Recently, DTC has implemented a similar depository settlement system for the commercial paper market, and could, but for limitations in present Article 8, handle other forms of short-term money market securities such as bankers' acceptances. For trading in mortgage-backed securities, such as Ginnie Mae's, a similar depository settlement system has been developed by Participants Trust Company. For trading in U.S. Treasury securities, a somewhat analogous book-entry system is operated under Treasury rules by the Federal Reserve System.

D. Need for Different Legal Rules for the Direct and Indirect Holding Systems

Both the traditional paper-based system, and the uncertificated system contemplated by the 1978 amendments, can be described as "direct" securities holding systems; that is, the beneficial owners of securities have a direct relationship with the issuer of the securities. For securities in bearer form, whoever has possession of the certificate thereby has a direct claim against the issuer. For registered securities, the registered owner, whether of certificated or uncertificated securities, has a direct relationship with the issuer by virtue of being recorded as the owner on the records maintained by the issuer or its transfer agent.

By contrast, the DTC depository system for corporate equity and debt securities can be described as an "indirect holding" system, that is, the issuer's records do not show the identity of all of the beneficial owners. Instead, a large portion of the outstanding securities of any given issue are recorded on the issuer's records as belonging to a depository. The depository's records in turn show the identity of the banks or brokers who are its members, and the records of those securities intermediaries show the identity of their customers.

Even after the 1978 amendments, the rules of Article 8 did not deal effectively with the indirect holding system. The rules of the 1978 version of Article 8 were based on the assumption that changes in ownership of securities would still be effected either by delivery of physical certificates or by registration of transfer on the books of the issuer. Yet in the indirect holding system, settlement of the vast majority of securities trades does not involve either of these events. For most, if not all, of the securities held through DTC, physical certificates representing DTC's total position do exist. These "jumbo certificates," however, are never delivered from person to person. Just as nothing ever happens to these certificates, virtually nothing happens to the official registry of stockholders maintained by the issuers or their transfer agents to reflect the great bulk of the changes in ownership of shares that occur each day.

The principal mechanism through which securities trades are settled today is not delivery of certificates or registration of transfers on the issuer's books, but netted settlement arrangements and accounting entries on the books of a multi-tiered pyramid of securities intermediaries. Herein is the basic problem. Virtually all of the rules of the prior version of Article 8 specifying how changes in ownership of securities are effected, and what happens if something goes awry in the process, were keyed to the concepts of a transfer of physical certificates or registration of transfers on the books of the issuers, yet that is not how changes in ownership are actually reflected in the modern securities holding system.

II. BRIEF OVERVIEW OF REVISED ARTICLE 8

A. Drafting Approach — Neutrality Principle

One of the objectives of the revision of Article 8 is to devise a structure of commercial law rules for investment securities that will be sufficiently flexible to respond to changes in practice over the next few decades. If it were possible to predict with confidence how the securities holding and trading system would develop, one could produce a statute designed specifically for the system envisioned. Recent experience, however, shows the danger of that approach. The 1978 amendments to Article 8 were based on the assumption that the solution to the problems that plagued the paper-based securities trading system of the 1960s would be the development of uncertificated securities. Instead, the solution thus far has been the development of the indirect holding system.

If one thought that the indirect holding system would come to dominate securities holding, one might draft Article 8 rules designed primarily for the indirect holding system, giving limited attention to the traditional direct holding system of security certificates or any uncertificated version of a direct holding system that might develop in the future. It is, however, by no means clear whether the long-term evolution will be toward decreased or increased use of direct holdings. At present, investors in most equity

securities can either hold their securities through brokers or request that certificates be issued in their own name. For the immediate future it seems likely that that situation will continue. One can imagine many plausible scenarios for future evolution. Direct holding might become less and less common as investors become more familiar and comfortable with book-entry systems and/or as market or regulatory pressures develop that discourage direct holding. One might note, for example, that major brokerage firms are beginning to impose fees for having certificates issued and that some observers have suggested that acceleration of the cycle for settlement of securities trades might be facilitated by discouraging customers from obtaining certificates. On the other hand, other observers feel that it is important for investors to retain the option of holding securities in certificated form, or at least in some form that gives them a direct relationship with the issuer and does not require them to hold through brokers or other securities intermediaries. Some groups within the securities industry are beginning to work on development of uncertificated systems that would preserve this option.

Revised Article 8 takes a neutral position on the evolution of securities holding practices. The revision was based on the assumption that the path of development will be determined by market and regulatory forces and that the Article 8 rules should not seek to influence that development in any specific direction. Although various drafting approaches were considered, it became apparent early in the revision process that the differences between the direct holding system and the indirect holding system are sufficiently significant that it is best to treat them as separate systems requiring different legal concepts. Accordingly, while the rules of the prior version of Article 8 have, in large measure, been retained for the direct holding system, a new Part 5 has been added, setting out the commercial law rules for the indirect securities holding system. The principle of neutrality does carry some implications for the design of specific Article 8 rules. At the very least, the Article 8 rules for all securities holding systems should be sufficiently clear and predictable that uncertainty about the governing law does not itself operate as a constraint on market developments. In addition, an effort has been made to identify and eliminate any Article 8 rules that might act as impediments to any of the foreseeable paths of development.

B. Direct Holding System

With respect to securities held directly, Revised Article 8 retains the basic conceptual structure and rules of present law. Part 2, which is largely unchanged from former law, deals with certain aspects of the obligations of issuers. The primary purpose of the rules of Part 2 is to apply to investment securities the principles of negotiable instruments law that preclude the issuers of negotiable instruments from asserting defenses against subsequent purchasers. Part 3 deals with transfer for securities held directly. One of its principal purposes is to apply to investment securities the principles of negotiable instruments law that protect purchasers of negotiable instruments against adverse claims. Part 4 deals with the process of registration of transfer by the issuer or transfer agent.

Although the basic concepts of the direct holding system rules have been retained, there are significant changes in terminology, organization, and statement of the rules. Some of the major changes are as follows:

Simplification of Part 3. The addition of the new Part 5 on the indirect holding system makes unnecessary the rather elaborate provisions of former law, such as those in Section 8-313, that sought to fit the indirect holding system into the conceptual structure of the direct holding system. Thus, Part 3 of Revised Article 8 is, in many respects, more similar to the original version of Article 8 than to the 1978 version.

Protected purchaser. The prior version of Article 8 used the term "bona fide purchaser" to refer to those purchasers who took free from adverse claims, and it used the phrase "good faith" in stating the requirements for such status. In order to promote clarity, Revised Article 8 states the rules that protect purchasers against adverse claims without using the phrase "good faith" and uses the new term "protected purchaser" to refer to purchasers in the direct holding system who are protected against adverse claims. See Sections 8-105 and 8-303.

Certificated versus uncertificated securities. The rules of the 1978 version of Article 8 concerning uncertificated securities have been simplified considerably. The 1978 version added provisions on uncertificated securities parallel to the provisions of the original version of Article 8 dealing with securities represented by certificates. Thus, virtually every section had one set of rules on "certificated securities" and another on "uncertificated securities." The constant juxtaposition of "certificated securities" and "uncertificated securities" has probably led readers to overemphasize the differences. Revised Article 8 has a unitary definition of "security" in Section 8-102(a)(15) which refers to the underlying intangible interest or obligation. In Revised Article 8, the difference between certificated and uncertificated is treated not as an inherent attribute of the security but as a difference in the means by which ownership is evidenced. The terms "certificated" and "uncertificated" security are used in those sections where it is important to distinguish between these two means of evidencing ownership. Revised Article 8 also deletes the provisions of the 1978 version concerning "transaction statements" and "registered pledges." These changes are explained in the Revision Notes 3, 4, and 5, below.

Scope of Parts 2, 3, and 4. The rules of Parts 2, 3, and 4 deal only with the rights of persons who hold securities directly. In typical securities holding arrangements in the modern depository system, only the clearing corporation would be a direct holder of the securities. Thus, while the rules of Parts 2, 3, and 4 would apply to the relationship between the issuer and the clearing corporation, they have no application to relationships below the clearing corporation level. Under Revised Article 8, a person who holds a security through a broker or securities custodian has a security entitlement governed by the Part 5 rules but is not the direct holder of the security. Thus, the rules of Revised Section 8-303 on the rights of "protected purchasers," which are the analog of the bona fide purchaser rules of former Article 8, do not apply to persons who hold securities through brokers or securities custodians. Instead, Part 5 contains its own rules to protect investors in the indirect holding system against adverse claims. See Revised Section 8-502.

C. Indirect Holding System

Although the Revised Article 8 provisions for the indirect holding system are somewhat complex, the basic approach taken can be summarized rather briefly. Revised Article 8 abandons the attempt to describe all of the complex relationships in the indirect holding system using the simple concepts of the traditional direct holding system. Instead, new rules specifically designed for the indirect holding system are added as Part 5 of Article 8. In a nutshell, the approach is to describe the core of the package of rights of a person who holds a security through a securities intermediary and then give that package of rights a name.

The starting point of Revised Article 8's treatment of the indirect holding system is the concept of "security entitlement." The term is defined in Section 8-102(a)(17) as "the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5." Like many legal concepts, however, the meaning of "security entitlement" is to be found less in any specific definition than in the matrix of rules that use the term. In a sense, then, the entirety of Part 5 is the definition of "security entitlement" because the Part 5 rules specify the rights and property interest that comprise a security entitlement.

Part 5 begins by specifying, in Section 8-501, when an entitlement holder acquires a security entitlement. The basic rule is very simple. A person acquires a security entitlement when the securities intermediary credits the financial asset to the person's account. The remaining sections of Part 5 specify the content of the security entitlement concept. Section 8-504 provides that a securities intermediary must maintain a sufficient quantity of financial assets to satisfy the claims of all of its entitlement holders. Section 8-503 provides that these financial assets are held by the intermediary for the entitlement holders, are not the property of the securities intermediary, and are not subject to claims of the intermediary's general creditors. Thus, a security entitlement is itself a form of property interest not merely an in personam claim against the intermediary. The concept of a security entitlement does, however, include a package of in personam rights against the intermediary. Other Part 5 rules identify the core of this package of rights, subject to specification by agreement and regulatory law. See Sections 8-505 through 8-509.

To illustrate the basic features of the new rules, consider a simple example of two investors, John and Mary, each of whom owns 1000 shares of Acme, Inc., a publicly traded company. John has a certificate representing his 1000 shares and is registered on the books maintained by Acme's transfer agent as the holder of record of those 1000 shares. Accordingly, he has a direct claim against the issuer, he receives dividends and distributions directly from the issuer, and he receives proxies directly from the issuer for purposes of voting his shares. Mary has chosen to hold her securities through her broker. She does not have a certificate and is not registered on Acme's stock books as a holder of record. She enjoys the economic and corporate benefits of ownership but does so through her broker and any other intermediaries in the chain back to the issuer. John's interest in Acme common stock would be described under Revised Article 8 as a direct interest in a "security." Thus, if John grants a security interest in his investment position, the collateral would be described as a "security." Mary's interest in Acme common stock would be described under Revised Article 8 as a "security entitlement." Thus, if Mary grants a security interest in her investment position, the collateral would be described as a "security entitlement."

For many purposes, there is no need to differentiate among the various ways that an investor might hold securities. For example, for purposes of financial accounting, John and Mary would each be described as the owner of 1000 shares of Acme common stock. For those purposes it is irrelevant that John is the registered owner and has physical possession of a certificate, while Mary holds her position through an intermediary. Revised Article 8 recognizes this point in Section 8-104 which provides that acquiring a security entitlement and acquiring a security certificate are different ways of acquiring an interest in the underlying security.

D. Security Interests

Along with the revision of Article 8, significant changes have been made in the rules concerning security interests in securities. The revision returns to the pre-1978 structure in which the rules on security interests in investment se-

curities are set out in Article 9, rather than in Article 8. The changes in Article 9 are, in part, conforming changes to adapt Article 9 to the new concept of a security entitlement. The Article 9 changes, however, go beyond that to establish a simplified structure for the creation and perfection of security interests in investment securities, whether held directly or indirectly. In order to avoid disruption of the current numbering sequence of Article 9, the new rules on security interests in investment securities are primarily set out in a new Section 9-115.

The Revised Article 9 rules continue the long-established principle that a security interest in a security represented by a certificate can be perfected by a possessory pledge. The revised rules, however, do not require that all security interests in investment securities be implemented by procedures based on the conceptual structure of the common law pledge. Under the revised Article 9 rules, a security interest in securities can be created pursuant to Section 9-203 in the same fashion as a security interest in any other form of property, that is, by agreement between the debtor and secured party. There is no requirement of a "transfer," "delivery," or any similar action, physical or metaphysical, for the creation of an effective security interest. A security interest in securities is, of course, a form of property interest, but the only requirements for creation of this form of property interest are those set out in Section 9-203.

The perfection methods for security interests in investment securities are set out in Revised Section 9-115(4). The basic rule is that a security interest may be perfected by "control." The concept of control, defined in Section 8-106, plays an important role in both Article 8 and Article 9. In general, obtaining control means taking the steps necessary to place the lender in a position where it can have the collateral sold off without the further cooperation of the debtor. Thus, for certificated securities, a lender obtains control by taking possession of the certificate with any necessary indorsement. For securities held through a securities intermediary, the lender can obtain control in two ways. First, the lender obtains control if it becomes the entitlement holder; that is, has the securities positions transferred to an account in its own name. Second, the lender obtains control if the securities intermediary agrees to act on instructions from the secured party to dispose of the positions, even though the debtor remains the entitlement holder. Such an arrangement suffices to give the lender control even though the debtor retains the right to trade and exercise other ordinary rights of an entitlement holder.

Except where the debtor is itself a securities firm, filing of an ordinary Article 9 financing statement is also a permissible alternative method of perfection. However, filing with respect to investment property does not assure the lender the same protections as for other forms of collateral, since the priority rules provide that a secured party who obtains control has priority over a secured party who does not obtain control.

The details of the new rules on security interests, as applied both to the retail level and to arrangements for secured financing of securities dealers, are explained in the Official Comments to Section 9-115.

III. SCOPE AND APPLICATION OF ARTICLE 8

A. Terminology

To understand the scope and application of the rules of Revised Article 8, and the related security interest rules of Article 9, it is necessary to understand some of the key defined terms:

Security, defined in Section 8-102(a)(15), has essentially the same meaning as under the prior version of Article 8. The difference in Revised Article 8 is that the definition of security does not determine the coverage of all of Article 8. Although the direct holding system rules in Parts 2, 3, and 4 apply only to securities, the indirect holding system rules of Part 5 apply to the broader category of "financial assets."

Financial asset, defined in Section 8-103(a)(9), is the term used to describe the forms of property to which the indirect holding system rules of Part 5 apply. The term includes not only "securities," but also other interests, obligations, or property that are held through securities accounts. The best illustration of the broader scope of the term financial asset is the treatment of money market instruments, discussed below.

Security entitlement, defined in Section 8-103(a)(17), is the term used to describe the property interest of a person who holds a security or other financial asset through a securities intermediary.

Securities intermediary, defined in Section 8-103(a)(14), is the term used for those who hold securities for others in the indirect holding system. It covers clearing corporations, banks acting as securities custodians, and brokers holding securities for their customers.

Entitlement holder, defined in Section 8-103(a)(7), is the term used for those who hold securities through intermediaries.

Securities account, defined in Section 8-501(a), describes the form of arrangement between a securities intermediary and an entitlement holder that gives rise to a security entitlement. As explained below, the definition of securities account plays a key role in setting the scope of the indirect holding system rules of Part 5.

Investment property, defined in Section 9-115(1)(f), determines the application of the new Article 9 rules for secured transactions. In addition to securities and security entitlements,

the Article 9 term "investment property" is defined to include "securities account" in order to simplify the drafting of the Article 9 rules that permit debtors to grant security interests either in specific security entitlements or in an entire securities account. The other difference between the coverage of the Article 8 and Article 9 terms is that commodity futures contracts are excluded from Article 8, but are included within the Article 9 definition of "investment property." Thus, the new Article 9 rules apply to security interests in commodity futures positions as well as security interests in securities positions.

B. Notes on Scope of Article 8

Article 8 is in no sense a comprehensive codification of the law governing securities or transactions in securities. Although Article 8 deals with some aspects of the rights of securities holders against issuers, most of that relationship is governed not by Article 8, but by corporation, securities, and contract law. Although Article 8 deals with some aspects of the rights and duties of parties who transfer securities, it is not a codification of the law of contracts for the purchase or sale of securities. (The prior version of Article 8 did include a few miscellaneous rules on contracts for the sale of securities, but these have not been included in Revised Article 8). Although the new indirect holding system rules of Part 5 deal with some aspects of the relationship between brokers or other securities professionals and their customers, Article 8 is still not in any sense a comprehensive code of the law governing the relationship between broker-dealers or other securities intermediaries and their customers. Most of the law governing that relationship is the common law of contract and agency, supplemented or supplanted by regulatory law.

The distinction between the aspects of the broker-customer relationship that are and are not dealt with in this Article may be illuminated by considering the differing roles of the broker in a typical securities transaction, in which the broker acts as agent for the customer. When a customer directs a broker to buy or sell securities for the customer, and the broker executes that trade on a securities exchange or in the over the counter market, the broker is entering into a contract for the purchase or sale of the securities as agent of the customer. The rules of the exchange, practices of the market, or regulatory law will specify when and how that contract is to be performed. For example, today the terms of the standard contract for trades in most corporate securities require the seller to deliver the securities, and the buyer to pay for them, five business days after the date that the contract was made, although the SEC has recently promulgated a rule that will accelerate the cycle to require settlement in three business days. In the common speech of the industry, the transaction in which the broker enters into a contract for the purchase or sale of the securities is referred to as executing the trade, and the transaction in which the securities are delivered and paid for is referred to as settlement. Thus, the current settlement cycle is known as T+5, that is, settlement is required on the fifth business day after the date of the trade, and the new SEC rule will change it to T+3. One must be careful in moving from the jargon of the securities industry to the jargon of the legal profession. For most practical economic purposes, the trade date is the date that counts, because that is the time at which the price is set, the risk of price changes shifts, and the parties become bound to perform. For purposes of precise legal analysis, however, the securities phrase "trade" or "execute a trade" means enter into a contract for the purchase or sale of the securities. The transfer of property interests occurs not at the time the contract is made but at the time it is performed, that is, at settlement.

The distinction between trade and settlement is important in understanding the scope of Article 8. Article 8 deals with the settlement phase of securities transactions. It deals with the mechanisms by which interests in securities are transferred, and the rights and duties of those who are involved in the transfer process. It does not deal with the process of entering into contracts for the transfer of securities or regulate the rights and duties of those involved in the contracting process. To use securities parlance, Article 8 deals not with the trade, but with settlement of the trade. Indeed, Article 8 does not even deal with all aspects of settlement. In a netted clearance and settlement system such as the NSCC-DTC system, individual trades are not settled one-by-one by corresponding entries on the books of any depository. Rather, settlement of the individual trades occurs through the clearing arrangements, in accordance with the rules and agreements that govern those arrangements.

In the rules dealing with the indirect holding system, one must be particularly careful to bear in mind the distinction between trade and settlement. Under Revised Article 8, the property interest of a person who holds securities through an intermediary is described as a "security entitlement," which is defined in Revised Section 8-102(a)(17) as the package of rights and property interest of an entitlement holder specified in Part 5. Saying that the security entitlement is a package of rights against the broker does not mean that all of the customer's rights against the broker are part of the security entitlement and hence part of the subject matter of Article 8. The distinction between trade and settlement remains fundamental. The rules of this Article on the indirect holding system deal with brokers and other intermediaries as media through which investors hold their financial assets. Brokers are also media through which investors buy

and sell their financial assets, but that aspect of their role is not the subject of this Article.

The principal goal of the Article 8 revision project is to provide a satisfactory framework for analysis of the indirect holding system. The technique used in Revised Article 8 is to acknowledge explicitly that the relationship between a securities intermediary and its entitlement holders is sui generis, and to state the applicable commercial law rules directly, rather than by inference from a categorization of the relationship based on legal concepts of a different era. One of the consequences of this drafting technique is that in order to provide content to the concept of security entitlement it becomes necessary to identify the core of the package of rights that make up a security entitlement. Sections 8-504 through 8-508 cover such basic matters as the duty of the securities intermediary to maintain a sufficient quantity of securities to satisfy all of its entitlement holders, the duty of the securities intermediary to pass through to entitlement holder the economic and corporate law rights of ownership of the security, and the duty of the securities intermediary to comply with authorized entitlement orders originated by the entitlement holder. These sections are best thought of as definitional; that is, a relationship which does not include these rights is not the kind of relationship that Revised Article 8 deals with. Because these sections take the form of statements of the duties of an intermediary toward its entitlement holders, one must be careful to avoid a distorted perspective on what Revised Article 8 is and is not designed to do. Revised Article 8 is not, and should not be, a comprehensive body of private law governing the relationship between brokers and their customers, nor a body of regulatory law to police against improper conduct by brokers or other intermediaries. Many, if not most, aspects of the relationship between brokers and customers are governed by the common law of contract and agency, supplemented or supplanted by federal and state regulatory law. Revised Article 8 does not take the place of this body of private and regulatory law. If there are gaps in the regulatory law, they should be dealt with as such; Article 8 is not the place to address them. Article 8 deals with how interests in securities are evidenced and how they are transferred. By way of a rough analogy, one might think of Article 8 as playing the role for the securities markets that real estate recording acts play for the real estate markets. Real estate recording acts do not regulate the conduct of parties to real estate transactions; Article 8 does not regulate the conduct of parties to securities transactions.

C. Application of Revised Articles 8 and 9 to Common Investments and Investment Arrangements

It may aid understanding to sketch briefly the treatment under Revised Articles 8 and 9 of a variety of relatively common products and arrangements.

1. Publicly traded stocks and bonds.

"Security" is defined in Revised Section 8-102(a)(15) in substantially the same terms as in the prior version of Article 8. It covers the ordinary publicly traded investment securities, such as corporate stocks and bonds. Parts 2, 3, and 4 govern the interests of persons who hold securities directly, and Part 5 governs the interest of those who hold securities indirectly.

Ordinary publicly traded securities provide a good illustration of the relationship between the direct and indirect holding system rules. The distinction between the direct and indirect holding systems is not an attribute of the securities themselves but of the way in which a particular person holds the securities. Thus, whether one looks to the direct holding system rules of Parts 2, 3, and 4 or the indirect holding system rules of Part 5 will depend on the level in the securities holding system being analyzed.

Consider, for example, corporate stock which is held through a depository, such as DTC. The clearing corporation, or its nominee, is the registered owner of all of the securities it holds on behalf of all of its participants. Thus the rules of Parts 2, 3, and 4 of Revised Article 8 apply to the relationship between the issuer and the clearing corporation. If, as is typically the case today, the securities are still represented by certificates, the clearing corporation will be the holder of the security certificate or certificates representing its total holdings. So far as Article 8 is concerned, the relationship between the issuer and the clearing corporation is no different from the relationship between the issuer and any other registered owner.

The relationship between the clearing corporation and its participants is governed by the indirect holding system rules of Part 5. At that level, the clearing corporation is the securities intermediary and the participant is the entitlement holder. If the participant is itself a securities intermediary, such as a broker holding for its customers or a bank acting as a securities custodian, the Part 5 rules apply to its relationship to its own customers. At that level the broker or bank custodian is the securities intermediary and the customer is the entitlement holder. Note that the broker or bank custodian is both an entitlement holder and a securities intermediary — but is so with respect to different security entitlements. For purposes of Article 8 analysis, the customer's security entitlement against the broker or bank custodian is a different item of property from the security entitlement of the broker or bank custodian against the clearing corporation.

For investors who hold their securities directly, it makes no difference that some other investors hold their interests indirectly. Many investors today choose to hold their securities

directly, becoming the registered owners on the books of the issuer and obtaining certificates registered in their names. For such investors, the addition of the new indirect holding system rules to Article 8 is entirely irrelevant. They will continue to deal directly with the issuers, or their transfer agents, under essentially the same rules as in the prior version of Article 8.

The securities holding options available to investors in a particular form of security may depend on the terms of the security. For example, direct holding is frequently not available for new issues of state and local government bonds. At one time, state and local government bonds were commonly issued in bearer form. Today, however, new issues of state and local government bonds must be in registered form and most are issued in what is known as "book-entry only" form; that is, the issuer specifies that the only person it will directly register as the registered owner is a clearing corporation. Thus, one of the inherent terms of the security is that investors can hold only in the indirect holding system.

2. Treasury securities.

U.S. government securities fall within the definition of security in Article 8 and therefore are governed by Article 8 in the same fashion as any other publicly held debt security, except insofar as Article 8 is preempted by applicable federal law or regulation.

New Treasury securities are no longer issued in certificated form; they can be held only through the book-entry systems established by the Treasury and Federal Reserve Banks. The Treasury offers a book-entry system, known as "Treasury Direct" which enables individual investors to have their positions recorded directly on the books of a Federal Reserve Bank, in a fashion somewhat similar to the uncertificated direct holding system contemplated by the 1978 version of Article 8. The governing law for the Treasury Direct system, however, is set out in the applicable Treasury regulations. The Treasury Direct system is not designed for active trading.

The great bulk of Treasury securities are held not through the Treasury Direct system but through a multi-tiered indirect holding system. The Federal Reserve Banks, acting as fiscal agent for the Treasury, maintain records of the holdings of member banks of the Federal Reserve System, and those banks in turn maintain records showing the extent to which they are holding for themselves or their own customers, including government securities dealers, institutional investors, or smaller banks who in turn may act as custodians for investors. The indirect holding system for Treasury securities was established under federal regulations promulgated in the 1970s. In the 1980s, Treasury released the proposed TRADES regulations that would have established a more comprehensive body of federal commercial law for the Treasury holding system. During the Article 8 revision process, Treasury withdrew these regulations, anticipating that once Revised Article 8 is enacted, it will be possible to base the law for the Treasury system on the new Article 8 rules.

3. Broker-customer relationships.

Whether the relationship between a broker and its customer is governed by the Article 8 Part 5 rules depends on the nature of the services that the broker performs for the customer.

Some investors use brokers only to purchase and sell securities. These customers take delivery of certificates representing the securities they purchase and hold them in their own names. When they wish to sell, they deliver the certificates to the brokers. The Article 8 Part 5 rules would not affect such customers, because the Part 5 rules deal with arrangements in which investors hold securities through securities intermediaries. The transaction between the customer and broker might be the traditional agency arrangement in which the broker buys or sells on behalf of the customer as agent for an undisclosed principal, or it might be a dealer transaction in which the "broker" as principal buys from or sells to the customer. In either case, if the customer takes delivery and holds the securities directly, she will become the "purchaser" of a "security" whose interest therein is governed by the rules of Parts 2, 3, and 4 of Article 8. If the customer meets the other requirements of Section 8-303(a), the customer who takes delivery can qualify as a "protected purchaser" who takes free from any adverse claims under Section 8-303(b). The broker's role in such transactions is primarily governed by non-Article 8 law. There are only a few provisions of Article 8 that affect the relationship between the customer and broker in such cases. See Sections 8-108 (broker makes to the customer the warranties of a transferor) and 8-115 (broker not liable in conversion if customer was acting wrongfully against a third party in selling securities).

Many investors use brokers not only to purchase and sell securities, but also as the custodians through whom they hold their securities. The indirect holding system rules of Part 5 apply to the custodial aspect of this relationship. If a customer purchases a security through a broker and directs the broker to hold the security in an account for the customer, the customer will never become a "purchaser" of a "security" whose interest therein is governed by the rules of Parts 2, 3, and 4 of Article 8. Accordingly, the customer does not become a "protected purchaser" under Section 8-303. Rather, the customer becomes an "entitlement holder" who has a "security entitlement" to the security against the broker as "securities intermediary." See Section 8-501. It would make no sense to say that the customer in such a case takes an

interest in the security free from all other claims, since the nature of the relationship is that the customer has an interest in common with other customers who hold positions in the same security through the same broker. Section 8-502, however, does protect an entitlement holder against adverse claims, in the sense that once the entitlement holder has acquired the package of rights that comprise a security entitlement no one else can take that package of rights away by arguing that the transaction that resulted in the customer's acquisition of the security entitlement was the traceable product of a transfer or transaction that was wrongful as against the claimant.

4. Bank deposit accounts; brokerage asset management accounts.

An ordinary bank deposit account would not fall within the definition of "security" in Section 8-102(a)(15), so the rules of Parts 2, 3, and 4 of Article 8 do not apply to deposit accounts. Nor would the relationship between a bank and its depositors be governed by the rules of Part 5 of Article 8. The Part 5 rules apply to "security entitlements." Section 8-501(b) provides that a person has a security entitlement when a securities intermediary credits a financial asset to the person's "securities account." "Securities account" is defined in Section 8-501(a) as "an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset." The definition of securities account plays a key role in setting the scope of Part 5 of Article 8. A person has a security entitlement governed by Part 5 only if the relationship in question falls within the definition of "securities account." The definition of securities account in Section 8-501(a) excludes deposit accounts from the Part 5 rules of Article 8. One of the basic elements of the relationship between a securities intermediary and an entitlement holder is that the securities intermediary has the duty to hold exactly the quantity of securities that it carries for the account of its customers. See Section 8-504. The assets that a securities intermediary holds for its entitlement holder are not assets that the securities intermediary can use in its own proprietary business. See Section 8-503. A deposit account is an entirely different arrangement. A bank is not required to hold in its vaults or in deposit accounts with other banks a sum of money equal to the claims of all of its depositors. Banks are permitted to use depositors' funds in their ordinary lending business; indeed, that is a primary function of banks. A deposit account, unlike a securities account, is simply a debtor-creditor relationship. Thus a bank or other financial institution maintaining deposit accounts is not covered by Part 5 of Article 8.

Today, it is common for brokers to maintain securities accounts for their customers which include arrangements for the customers to hold liquid "cash" assets in the form of money market mutual fund shares. Insofar as the broker is holding money market mutual fund shares for its customer, the customer has a security entitlement to the money market mutual fund shares. It is also common for brokers to offer their customers an arrangement in which the customer has access to those liquid assets via a deposit account with a bank, whereby shares of the money market fund are redeemed to cover checks drawn on the account. Article 8 applies only to the securities account; the linked bank account remains an account covered by other law. Thus the rights and duties of the customer and the bank are governed not by Article 8, but by the relevant payment system law, such as Article 4 or Article 4A.

5. Trusts.

The indirect holding system rules of Part 5 of Article 8 are not intended to govern all relationships in which one person holds securities "on behalf of" another. Rather, the Part 5 rules come into play only if the relationship in question falls within the definition of securities account in Section 8-501(a). The definition of securities account serves the important function of ensuring that ordinary trust arrangements are not inadvertently swept into Part 5 of Article 8. Suppose that Bank serves as trustee of a trust for the benefit of Beneficiary. The corpus of the trust is invested in securities and other financial assets. Although Bank is, in some senses, holding securities for Beneficiary, the arrangement would not fall within the definition of securities account. Bank, as trustee, has not undertaken to treat Beneficiary as entitled to exercise all of the rights that comprise the portfolio securities. For instance, although Beneficiary receives the economic benefit of the portfolio securities, Beneficiary does not have the right to direct dispositions of individual trust assets or to exercise voting or other corporate law rights with respect to the individual securities. Thus Bank's obligations to Beneficiary as trustee are governed by ordinary trust law, not by Part 5 of Article 8. Of course, if Bank, as trustee, holds the securities through an intermediary, Part 5 of Revised Article 8 would govern the relationship between Bank, as entitlement holder, and the intermediary through which Bank holds the securities. It is also possible that a different department of Bank acts as the intermediary through which Bank, as trustee, holds the securities. Bank, qua securities custodian, might be holding securities for a large number of customers, including Bank's own trust department. Insofar as Bank may be regarded as acting in different capacities, Part 5 of Article 8 may be relevant to the relationship between the two sides of Bank's business. However, the relationship between

Bank as trustee and the beneficiaries of the trust would remain governed by trust law, not Article 8.

6. Mutual fund shares.

Shares of mutual funds are Article 8 securities, whether the fund is organized as a corporation, business trust, or other form of entity. See Sections 8-102(a)(15) and 8-103(b). Mutual funds commonly do not issue certificates. Thus, mutual fund shares are typically uncertificated securities under Article 8.

Although a mutual fund is, in a colloquial sense, holding the portfolio securities on behalf of the fund's shareholders, the indirect holding system rules of Part 5 do not apply to the relationship between the fund and its shareholders. The Part 5 rules apply to "security entitlements." Section 8-501(e) provides that issuance of a security is not establishment of a security entitlement. Thus, because mutual funds shares do fit within the Article 8 definition of security, the relationship between the fund and its shareholders is automatically excluded from the Part 5 rules.

Of course, a person might hold shares in a mutual fund through a brokerage account. Because mutual fund shares are securities, they automatically fall within the broader term "financial asset," so the Part 5 indirect holding system rules apply to mutual fund shares that are held through securities accounts. That is, a person who holds mutual fund shares through a brokerage account could have a security entitlement to the mutual fund shares, just as the person would have a security entitlement to any other security carried in the brokerage account.

7. Stock of closely held corporations.

Ordinary corporate stock falls within the Article 8 definition of security, whether or not it is publicly traded. See Sections 8-102(a)(15) and 8-103(a). There is nothing in the new indirect holding system rules of Article 8 that would preclude their application to shares of companies that are not publicly traded. The indirect holding system rules, however, would come into play only if the shares were in fact held through a securities account with a securities intermediary. Since that is typically not the case with respect to shares of closely held corporations; transactions involving those shares will continue to be governed by the traditional rules, as amended, that are set out in Parts 2, 3, and 4 of Article 8, and the corresponding provisions of Article 9. The simplification of the Article 8 rules on uncertificated securities may, however, make the alternative of dispensing with certificates more attractive for closely held corporations.

8. Partnership interests and limited liability company shares.

Interests in partnerships or shares of limited liability companies are not Article 8 securities unless they are in fact dealt in or traded on securities exchanges or in securities markets. See Section 8-103(c). The issuers, however, may if they wish explicitly "opt-in" by specifying that the interests or shares are securities governed by Article 8. Even though interests in partnerships or shares of limited liability companies do not generally fall within the category of "security" in Article 8, they would fall within the broader term "financial asset." Accordingly, if such interests are held through a securities account with a securities intermediary, the indirect holding system rules of Part 5 apply, and the interest of a person who holds them through such an account is a security entitlement.

9. Bankers' acceptances, commercial paper, and other money market instruments.

Money market instruments, such as commercial paper, bankers' acceptances, and certificates of deposit, are good examples of a form of property that may fall within the definition of "financial asset," even though they may not fall within the definition of "security." Section 8-103(d) provides that a writing that meets the definition of security certificate under Section 8-102(a)(15) is governed by Article 8, even though it also fits within the definition of "negotiable instrument" in Article 3.

Some forms of short term money market instruments may meet the requirements of an Article 8 security, while others may not. For example, the Article 8 definition of security requires that the obligation be in registered or bearer form. Bankers' acceptances are typically payable "to order," and thus do not qualify as Article 8 securities. Thus, the obligations of the immediate parties to a bankers' acceptance are governed by Article 3, rather than Article 8. That is an entirely appropriate classification, even for those bankers' acceptance that are handled as investment media in the securities markets, because Article 8, unlike Article 3, does not contain rules specifying the standardized obligations of parties to instruments. For example, the Article 3 rules on the obligations of acceptors and drawers of drafts are necessary to specify the obligations represented by bankers' acceptances, but Article 8 contains no provisions dealing with these issues.

Immobilization through a depository system is, however, just as important for money market instruments as for traditional securities. Under the prior version of Article 8, the rules on the depository system, set out in Section 8-320, applied only to Article 8 securities. Although some forms of money market instruments could be fitted within the language of the Article 8 definition of "security," this is not true for bankers' acceptances. Accordingly, it was not thought feasible to make bankers' acceptances eligible for deposit in clearing corporations under the prior version of Article 8. Revised Article 8 solves this problem by separating the coverage of the Part 5 rules from the definition

of security. Even though a bankers' acceptance or other money market instrument is an Article 3 negotiable instrument rather than an Article 8 security, it would still fall within the definition of financial asset in Section 8-102(a)(9). Accordingly, if the instrument is held through a clearing corporation or other securities intermediary, the rules of Part 5 of Article 8 apply.

10. Repurchase agreement transactions.

Repurchase agreements are an important form of transaction in the securities business, particularly in connection with government securities. Repos and reverse repos can be used for a variety of purposes. The one that is of particular concern for purposes of commercial law rules is the use of repurchase agreements as a form of financing transaction for government securities dealers. Government securities dealers typically obtain intra-day financing from their clearing banks, and then at the end of the trading day seek overnight financing from other sources to repay that day's advances from the clearing bank. Repos are the principal source of this financing. The dealer ("repo seller") sells securities to the financing source ("repo buyer") for cash, and at the same time agrees to repurchase the same or like securities the following day, or at some other brief interval. The sources of the financing include a variety of entities seeking short term investments for surplus cash, such as pension funds, business corporations, money market funds, and banks. The pricing may be computed in various ways, but in essence the price at which the dealer agrees to repurchase the securities exceeds the price paid to the dealer by an amount equivalent to interest on the funds.

The transfer of the securities from a securities dealer as repo seller to a provider of funds as repo buyer can be effected in a variety of ways. The repo buyer might be willing to allow the repo seller to keep the securities "in its hands," relying on the dealer's representation that it will hold them on behalf of the repo buyer. In the jargon of the trade, these are known as "hold-in-custody repos" or "HIC repos." At the other extreme, the repo buyer might insist that the dealer "hand over" the securities so that in the event that the dealer fails and is unable to perform its obligation to repurchase them, the repo buyer will have the securities "in its hands." The jargon for these is "delivered-out repos." A wide variety of arrangements between these two extremes might be devised, in which the securities are "handed over" to a third party with powers concerning their disposition allocated between the repo seller and repo buyer in a variety of ways.

Specification of the rights of repo buyers is complicated by the fact that the transfer of the interest in securities from the repo seller to the repo buyer might be characterized as an outright sale or as the creation of a security interest. Article 8 does not attempt to specify any categorical rules on that issue.

Article 8 sets out rules on the rights of parties who have implemented securities transactions in certain ways. It does not, however, deal with the legal characterization of the transactions that are implemented through the Article 8 mechanisms. Rather, the Article 8 rules apply without regard to the characterization of transactions for other purposes. For example, the Article 8 rules for the direct holding system provide that a person who takes delivery of a duly indorsed security certificate for value and without notice of adverse claims takes free from any adverse claims. That rule applies without regard to the character of the transaction in which the security certificate was delivered. It applies both to delivery upon original issue and to delivery upon transfer. It applies to transfers in settlement of sales and to transfers in pledge. Similarly, the Article 8 indirect holding system rules, such as the adverse claim cut-off rules in Sections 8-502 and 8-510, apply to the transactions that fall within their terms, whether those transactions were sales, secured transactions, or something else.

Repos involve transfers of interests in securities. The Article 8 rules apply to transfers of securities in repos, just as they apply to transfers of securities in any other form of transaction. The transfer of the interest in securities from the repo seller to the repo buyer might be characterized as an outright sale or as the creation of a security interest. Article 8 does not determine that question. The rules of Revised Article 8 have, however, been drafted to minimize the possibility that disputes over the characterization of the transfer in a repo would affect substantive questions that are governed by Article 8. See, e.g., Section 8-510 and Comment 4 thereto.

11. Securities lending transactions.

In a typical securities lending transaction, the owner of securities lends them to another person who needs the securities to satisfy a delivery obligation. For example, when a customer of a broker sells a security short, the broker executes an ordinary trade as seller and so must deliver the securities at settlement. The customer is "short" against the broker because the customer has an open obligation to deliver the securities to the broker, which the customer hopes to be able to satisfy by buying in the securities at a lower price. If the short seller's broker does not have the securities in its own inventory, the broker will borrow them from someone else. The securities lender delivers the securities to the borrowing broker, and the borrowing broker becomes contractually obligated to redeliver a like quantity of the same security. Securities borrowers are required to provide collateral, usually government securities, to assure performance of their redelivery obligation.

The securities lender does not retain any property interest in the securities that are delivered to the borrower. The transaction is an outright transfer in which the borrower obtains full title. The whole point of securities lending is that the borrower needs the securities to transfer them to someone else. It would make no sense to say that the lender retains any property interest in the securities it has lent. Accordingly, even if the securities borrower defaults on its redelivery obligation, the securities lender has no property interest in the original securities that could be asserted against any person to whom the securities borrower may have transferred them. One need not look to adverse claim cut-off rules to reach that result; the securities lender never had an adverse claim. The securities borrower's default is no different from any other breach of contract. The securities lender's protection is its right to foreclose on the collateral given to secure the borrower's redelivery obligation. Perhaps the best way to understand securities lending is to note that the word "loan" in securities lending transactions is used in the sense it carries in loans of money, as distinguished from loans of specific identifiable chattels. Someone who lends money does not retain any property interest in the money that is handed over to the borrower. To use civil law terminology, securities lending is mutuum, rather than commodatum. See Story on Bailments, 6 and 47.

12. Traded stock options.

Stock options issued and cleared through the Options Clearing Corporation ("OCC") are a good example of a form of investment vehicle that is treated as a financial asset to which the Part 5 rules apply, but not as an Article 8 security to which Parts 2, 3, and 4 apply. OCC carries on its books the options positions of the brokerage firms which are clearing members of OCC. The clearing members in turn carry on their books the options positions of their customers. The arrangements are structurally similar to the securities depository system. In the options structure, however, there is no issuer separate from the clearing corporation. The financial assets held through the system are standardized contracts entitling the holder to purchase or sell a certain security at a set price. Rather than being an interest in or obligation of a separate issuer, an option is a contractual right against the counter-party. In order to assure performance of the options, OCC interposes itself as counter-party to each options trade. The rules of Parts 2, 3, and 4 of this Article, however, do not well describe the obligations and rights of OCC. On the other hand, the rules of Part 5, and the related Article 9 rules on security interests and priorities, do provide a workable legal framework for the commercial law analysis of the rights of the participants in the options market. Accordingly, publicly traded securities options are included within the definition of "financial asset," but not "security." See Section 8-103(e). Thus, although OCC would not be an issuer of a security for purposes of this Article, it would be a clearing corporation, against whom its clearing members have security entitlements to the options positions. Similarly, the clearing members' customers have security entitlements against the clearing members. Traded stock options are also a good illustration of the point that the classification issues under Article 8 are very different from classification under other law, such as the federal securities laws. See Section 8-102(d). Stock options are treated as securities for purposes of federal securities laws, but not for purposes of Article 8.

13. Commodity futures.

Section 8-103(f) provides that a "commodity contract" is not a security or a financial asset. Section 9-115 defines commodity contract to include commodity futures contracts, commodity options, and options on commodity futures contracts that are traded on or subject to the rules of a board of trade that has been designated as a contract market for that contract pursuant to the federal commodities laws. Thus, commodity contracts themselves are not Article 8 securities to which the rules of Parts 2, 3, and 4 apply, nor is the relationship between a customer and a commodity futures commission merchant governed by the Part 5 rules of Article 8. Commodity contracts, however, are included within the Article 9 definition of "investment property." Thus security interests in commodity positions are governed by essentially the same set of rules as security interests in security entitlements.

14. "Whatever else they have or may devise."

The classification question posed by the above-captioned category of investment products and arrangements is among the most difficult — and important — issue raised by the Article 8 revision process. Rapid innovation is perhaps the only constant characteristic of the securities and financial markets. The rules of Revised Article 8 are intended to be sufficiently flexible to accommodate new developments.

A common mechanism by which new financial instruments are devised is that a financial institution that holds some security, financial instrument, or pool thereof, creates interests in that asset or pool which are sold to others. It is not possible to answer in the abstract the question of how such interests are treated under Article 8, because the variety of such products is limited only by human imagination and current regulatory structures. At this general level, however, one can note that there are at least three possible treatments under Article 8 of the relationship between the institution which creates the interests and the persons who hold them. (Again, it must be borne in mind that the Article 8 classification issue may be different from the classification question posed by federal securi-

ties law or other regulation.) First, creation of the new interests in the underlying assets may constitute issuance of a new Article 8 security. In that case the relationship between the institution that created the interest and the persons who hold them is not governed by the Part 5 rules, but by the rules of Parts 2, 3, and 4. See Section 8-501(e). That, for example, is the structure of issuance of mutual fund shares. Second, the relationship between the entity creating the interests and those holding them may fit within the Part 5 rules, so that the persons are treating as having security entitlements against the institution with respect to the underlying assets. That, for example, is the structure used for stock options. Third, it may be that the creation of the new interests in the underlying assets does not constitute issuance of a new Article 8 security, nor does the relationship between the entity creating the interests and those holding them fit within the Part 5 rules. In that case, the relationship is governed by other law, as in the case of ordinary trusts.

The first of these three possibilities — that the creation of the new interest is issuance of a new security for Article 8 purposes — is a fairly common pattern. For example, an American depositary receipt facility does not maintain securities accounts but issues securities called ADRs in respect of foreign securities deposited in such facility. Similarly, custodians of government securities which issue receipts, certificates, or the like representing direct interests in those securities (sometimes interests split between principal and income) do not maintain securities accounts but issue securities representing those interests. Trusts holding assets, in a variety of structured and securitized transactions, which issue certificates or the like representing "pass-through" or undivided beneficial interests in the trust assets, do not maintain securities accounts but issue securities representing those interests.

In analyzing these classification questions, courts should take care to avoid mechanical jurisprudence based solely upon exegesis of the wording of definitions in Article 8. The result of classification questions is that different sets of rules come into play. In order to decide the classification question it is necessary to understand fully the commercial setting and consider which set of rules best fits the transaction. Rather than letting the choice of rules turn on interpretation of the words of the definitions, the interpretation of the words of the definitions should turn on the suitability of the application of the substantive rules.

IV. CHANGES FROM PRIOR (1978) VERSION OF ARTICLE 8

A. Table of Disposition of Sections in Prior Version

Article 8 (1978)	Revised Articles 8 and 9
8-101	8-101
8-102(1)(a)	8-102(a)(4) & (15)
8-102(1)(b)	8-102(a)(15) & (18)
8-102(1)(c)	8-102(a)(15)
8-102(1)(d)	8-102(a)(13)
8-102(1)(e)	8-102(a)(2)
8-102(2)	8-202(b)(1)
8-102(3)	8-102(a)(5)
8-102(4)	omitted, see Revision Note 1
8-102(5)	8-102(b)
8-102(6)	8-102(c)
8-103	8-209
8-104	8-210
8-105(1)	omitted, see Revision Note 8
8-105(2)	omitted, see Revision Note 4
8-105(3)	8-114
8-106	8-110
8-107	omitted, see Revision Note 8
8-108	omitted, see Revision Note 5
8-201	8-201
8-202	8-202; transaction statement provisions omitted, see Revision Note 4
8-203	8-203
8-204	8-204; transaction statement provisions omitted, see Revision Note 4
8-205	8-205; transaction statement provisions omitted, see Revision Note 4
8-206	8-206; transaction statement provisions omitted, see Revision Note 4
8-207	8-207; registered pledge provisions omitted, see Revision Note 5
8-208	8-208; transaction statement provisions omitted, see Revision Note 4
8-301	8-302(a) & (b)
8-302(1)	8-303(a)
8-302(2)	8-102(a)(1)
8-302(3)	8-303(b)
8-302(4)	8-302(c)
8-303	8-102(a)(3)
8-304(1)	8-105(d)
8-304(2)	omitted, see Revision Note 4
8-304(3)	8-105(b)
8-305	8-105(c)
8-306(1)	8-108(f)
8-306(2)	8-108(a)
8-306(3)	8-108(g)
8-306(4)	8-108(h)
8-306(5)	8-108(e)
8-306(6)	8-306(h)
8-306(7)	8-108(b), 8-306(h)
8-306(8)	omitted, see Revision Note 5

8-306(9)	8-108(c)
8-306(10)	8-108(i)
8-307	8-304(d)
8-308(1)	8-102(a)(11), 8-107
8-308(2)	8-304(a)
8-308(3)	8-304(b)
8-308(4)	8-102(a)(12)
8-308(5)	8-107 & 8-305(a)
8-308(6)	8-107
8-308(7)	8-107
8-308(8)	8-107
8-308(9)	8-304(f) & 8-305(b)
8-308(10)	8-107
8-308(11)	8-107
8-309	8-304(c)
8-310	8-304(e)
8-311(a)	omitted, see 8-106(b)(2), 8-301(b)(1), 8-303
8-311(b)	8-404
8-312	8-306
8-313(1)(a)	omitted, see Revision Note 2; see also 8-301(a)(1) & (2)
8-313(1)(b)	omitted, see Revision Note 2; see also 8-301(b)(1) & (2)
8-313(1)(c)	omitted, see Revision Note 2; see also 8-301(a)(3)
8-313(1)(d)	omitted, see Revision Note 2; see also 8-501(b)
8-313(1)(e)	omitted, see Revision Note 2; see also 8-301(a)(2)
8-313(1)(f)	omitted, see Revision Note 2; see also 8-301(b)(2)
8-313(1)(g)	omitted, see Revision Notes 1 & 2; see also 8-501(b), 8-111
8-313(1)(h)-(j)	omitted, see Revision Note 2; see also 9-115 & 9-203
8-313(2)	omitted, see Revision Note 2; see also 8-503
8-313(3)	omitted, see Revision Note 2
8-313(4)	8-102(a)(14)
8-314	omitted, see Revision Note 8
8-315	omitted, see Revision Note 8
8-316	8-307
8-317	8-112
8-318	8-115
8-319	omitted, see 8-113 and Revision Note 7
8-320	omitted, see Revision Note 1
8-321	omitted, see 9-115, 9-203
8-401	8-401
8-402	8-402, see Revision Note 6
8-403	8-403, see Revision Note 6
8-404	8-404
8-405(1)	8-406
8-405(2)	8-405(a)
8-405(3)	8-405(b)
8-406	8-407
8-407	omitted, see Revision Note 8
8-408	omitted, see Revision Note 4

B. Revision Notes

1. Provisions of former Article 8 on clearing corporations.

The keystone of the treatment of the indirect holding system in the prior version of Article 8 was the special provision on clearing corporations in Section 8-320. Section 8-320 was added to Article 8 in 1962, at the very end of the process that culminated in promulgation and enactment of the original version of the Code. The key concepts of the original version of Article 8 were "bona fide purchaser" and "delivery." Under Section 8-302 (1962) one could qualify as a "bona fide purchaser" only if one had taken delivery of a security, and Section 8-313 (1962) specified what counted as a delivery.

Section 8-320 was added to take account of the development of the system in which trades can be settled by netted book-entry movements at a depository without physical deliveries of certificates. Rather than reworking the basic concepts, however, Section 8-320 brought the depository system within Article 8 by definitional fiat. Subsection (a) of Section 8-320 (1962) stated that a transfer or pledge could be effected by entries on the books of a central depository, and subsection (b) stated that such an entry "has the effect of a delivery of a security in bearer form or duly indorsed in blank." In 1978, Section 8-320 was revised to conform it to the general substitution of the concept of "transfer" for "delivery," but the basic structure remained the same. Under the 1978 version of Article 8, the only book-entry transfers that qualified the transferee for bona fide purchaser rights were those made on the books of a clearing corporation. See Sections 8-302(1)(c), 8-313(1)(g), and 8-320. Thus, for practical purposes, the indirect holding system rules of the prior version of Article 8 required that the securities be held by a clearing corporation in accordance with the central depository rules of Section 8-320.

Some of the definitional provisions concerning clearing corporation in the prior version of Article 8 seem to have conflated the commercial law rules on the effect of book-entry transactions with issues about the regulation of entities

that are acting as clearing corporations. For example, the Section 8-320 rules that gave effect to book-entry transfers applied only if the security was "in the custody of the clearing corporation, another clearing corporation, [or] a custodian bank." "Custodian bank" was defined in Section 8-102(4) as "a bank or trust company that is supervised and examined by state or federal authority having supervision over banks and is acting as custodian for a clearing corporation." Although this was probably inadvertent, these definitional provisions have operated as an obstacle to the development of clearing arrangements for global trading, since they effectively precluded clearing corporations from using foreign banks as custodians.

Revised Article 8 is based on the view that Article 8 is not the proper place for regulatory decisions about whether certain sorts of financial institutions should or should not be permitted to engage in a particular aspect of the securities business, such as acting as a clearing corporation, or how they should be permitted to conduct that business. Rather, Article 8 should deal only with the commercial law questions of what duties and rights flow from doing business as a clearing corporation, leaving it to other regulatory law to decide which entities should be permitted to act as clearing corporations, and to regulate their activities. Federal securities laws now establish a detailed regulatory structure for clearing corporations; there is no need for Article 8 to duplicate parts of that structure. Revised Article 8 deletes all provision of the prior version which had the effect of specifying how clearing corporations should conduct their operations. For example, Revised Article 8 deletes the definition of "custodian bank," which operated in the prior version only as a regulatory restriction on how clearing corporations could hold securities.

In general, the structure of Revised Article 8 is such that there is relatively little need for special provisions on clearing corporations. Book-entry transactions effected through clearing corporations are treated under the same rules in Part 5 as book-entry transactions effected through any other securities intermediary. Accordingly, Revised Article 8 has no direct analog of the special provisions in Section 8-320 on transfers on the books of clearing corporations.

2. Former Section 8-313 — "Transfer."

Section 8-313 of the 1978 version of Article was extremely complicated, because it attempted to cover many different issues. The following account of the evolution of Section 8-313 may assist in understanding why a different approach is taken in Revised Article 8. This explanation is, however, intended not as an actual account of historical events, but as a conceptual reconstruction, devised from the perspective of, and with the benefit of, hindsight.

The original objective of Article 8 was to ensure that certificates representing investment securities would be "negotiable" in the sense that purchasers would be protected by the bona fide purchaser rules. The requirements for bona fide purchaser status were that the purchaser had to (i) take delivery of the security and (ii) give value in good faith and without notice of adverse claims. Section 8-313 specified what counted as a "delivery," and Section 8-302 specified the other requirements.

The 1978 amendments added provisions on uncertificated securities, but the basic organizational pattern was retained. Section 8-302 continued to state the requirements of value, good faith, and lack of notice for good faith purchase, and Section 8-313 stated the mechanism by which the purchase had to be implemented. Delivery as defined in the original version of Section 8-313 had a meaning similar to the concept known in colloquial securities jargon as "good delivery"; that is, physical delivery with any necessary indorsement. Although the word "delivery" has now come to be used in securities parlance in a broader sense than physical delivery, when the provisions for uncertificated securities were added it was thought preferable to use another word. Thus, the word "transfer" was substituted for "delivery" in Section 8-313.

The 1978 amendments also moved the rules governing security interests in securities from Article 9 to Article 8, though the basic conceptual structure of the common law of pledge was retained. Since a pledge required a delivery, and since the term transfer had been substituted for delivery, the 1978 amendments provided that in order to create a security interest there must be a "transfer," in the defined Article 8 sense, from the debtor to the secured party. Accordingly, provisions had to be added to Section 8-313 so that any of the steps that should suffice to create a perfected security interest would be deemed to constitute a "transfer" within the meaning of Section 8-313. Thus, the Section 8-313 rules on "transfer," which had in the previous version dealt only with what counted as a delivery that qualified one for bona fide purchaser status, became the statutory locus for all of the rules on creation and perfection of security interests in securities. Accordingly the rather elaborate rules of subsections (1)(h), (1)(i), and (1)(j) were added.

Having expanded Section 8-313 to the point that it served as the rule specifying the formal requirements for transfer of all significant forms of interests in securities, it must have seemed only logical to take the next step and make the Section 8-313 rules the exclusive means of transferring interests in securities. Thus, while the prior version had stated that "Delivery to a purchaser occurs when ...", the 1978 version stated that "Transfer of a security or a limited interest (including a security interest) therein to

a purchaser occurs only ... ." Having taken that step, however, it then became necessary to ensure that anyone who should be regarded as having an interest in a security would be covered by some provision of Section 8-313. Thus, the provisions of subsection (1)(d)(ii) and (iii) were added to make it possible to say that the customers of a securities intermediary who hold interests in securities held by the intermediary in fungible bulk received "transfers."

Section 8-313(1)(d) was the key provision in the 1978 version dealing with the indirect holding system at the level below securities depositories. It operated in essentially the same fashion as Section 8-320; that is, it stated that when a broker or bank holding securities in fungible bulk makes entries on its books identifying a quantity of the fungible bulk as belonging to the customer, that action is treated as a "transfer" — in the special Section 8-313 sense — of an interest in the security from the intermediary to the customer.

Revised Article 8 has no direct analog of the 1978 version of Section 8-313. The rules on secured transactions have been returned to Article 9, so subsections of Section 8-313 (1978) dealing with security interests are deleted from Article 8. Insofar as portions of Section 8-313 (1978) were designed to specify the formal requirements for transferees to qualify for protection against adverse claims, their place is taken by Revised Section 8-301, which defines "delivery," in a fashion somewhat akin to the pre-1978 version of Section 8-313. The descendant of the provisions of Section 8-313 (1978) dealing with the indirect holding system is Revised Section 8-501 which specifies when a person acquires a security entitlement. Section 8-501, however, is based on a different analysis of the transaction in which a customer acquires a position in the indirect holding system. The transaction is not described as a "transfer" of an interest in some portion of a fungible bulk of securities held by the securities intermediary but as the creation of a security entitlement. Accordingly, just as Revised Article 8 has no direct analog of the Section 8-320 rules on clearing corporation transfers, it has no direct analog of the Section 8-313(1) rules on "transfers" of interests in securities held in fungible bulk.

3. Uncertificated securities provisions.

Given the way that securities holding practices have evolved, the sharp distinction that the 1978 version of Article 8 drew between certificated securities and uncertificated securities has become somewhat misleading. Since many provisions of the 1978 version had separate subsections dealing first with certificated securities and then with uncertificated securities, and since people intuitively realize that the volume of trading in the modern securities markets could not possibly be handled by pushing around certificates, it was only natural for a reader of the statute to conclude that the uncertificated securities provisions of Article 8 were the basis of the book-entry system. That, however, is not the case. Although physical delivery of certificates plays little role in the settlement system, most publicly traded securities are still, in legal theory, certificated securities. To use clearance and settlement jargon, the book-entry securities holding system has used "immobilization" rather than "dematerialization."

The important legal and practical difference is between the direct holding system, in which the beneficial owners have a direct relationship with the issuer, and the indirect holding system, in which securities are held through tiers of securities intermediaries. Accordingly, in Revised Article 8 the contrast between certificated securities and uncertificated securities has been minimized or eliminated as much as possible in stating the substantive provisions.

4. Transaction statements.

Although the 1978 provisions on uncertificated securities contemplated a system in which there would be no definitive certificates as reifications of the underlying interests or obligations, the 1978 amendments did not really dispense with all requirements of paper evidence of securities holding. The 1978 amendments required issuers of uncertificated securities to send paper "transaction statements" upon registration of transfer. Section 8-408 regulated the content and format of these transaction statements in considerable detail. The statements had to be in writing, include specific information, and contain a conspicuous legend stating that "This statement is merely a record of the rights of the addressee as of the time of its issuance. Delivery of this statement, of itself, confers no rights on the recipient. This statement is neither a negotiable instrument nor a security." Issuers were required to send statements when any transfer was registered (known as "initial transaction statements") and also were required to send periodic statements at least annually and also upon any security holder's reasonable request. Fees were regulated to some extent, in that Section 8-408(8) specified that if periodic statements were sent at least quarterly, the issuer could charge for statements requested by security holders at other times.

The detailed specification of reporting requirements for issuers of uncertificated securities was quite different from the treatment of securities intermediaries. Though the prior version of Article 8 did require non-clearing corporation securities intermediaries to send confirmations of transfers — a requirement deleted in Revised Article 8 — it did not regulate their content or format. Article 8 has never imposed periodic reporting requirements on securities intermediaries. Thus, reporting requirements for the indirect holding system were left to agreements and regulatory authorities, while report-

ing requirements for a book-entry direct holding system were imposed by statute.

Securities holding systems based on transaction statements of the sort contemplated by the 1978 amendments have not yet evolved to any major extent — indeed, the statutory specification of the details of the information system may itself have acted as an impediment to the evolution of a book-entry direct system. Accordingly, Revised Article 8 drops the statutory requirements concerning transaction statements. The record keeping and reporting obligations of issuers of uncertificated securities would be left to agreement and other law, as is the case today for securities intermediaries.

In the 1978 version, the Part 2 rules concerning transfer restrictions, issuers' defenses, and the like were based on the assumption that transaction statements would be used in a fashion analogous to traditional security certificates. For example, Sections 8-202 and 8-204 specified that the terms of a security, or any restrictions on transfer imposed by the issuer, had to be noted on the transaction statement. Revised Article 8 deletes all such references to transaction statements. The terms of securities, or of restrictions of transfer, would be governed by whatever law or agreement specifies these matters, just as is the case for various other forms of business entities, such as partnerships, that have never issued certificates representing interests. Other Part 2 rules, such as Sections 8-205, 8-206, and 8-208, attempted to state rules on forgery and related matters for transactions statements. Since Revised Article 8 does not specify the format for information systems for uncertificated securities, there is no point in attempting to state rules on the consequences of wrongful information transmission in the particular format of written statements authenticated by signatures.

5. Deletion of provisions on registered pledges.

The 1978 version of Article 8 also added detailed provisions concerning "registered pledges" of uncertificated securities. Revised Article 8 adopts a new system of rules for security interests in securities, for both the direct and indirect holding systems that make it unnecessary to have special statutory provisions for registered pledges of uncertificated securities.

The reason that the 1978 version of Article 8 created this concept was that if the only means of creating security interests was the pledge, it seemed necessary to provide some substitute for the pledge in the absence of a certificate. The point of the registered pledge was, presumably, that it permitted a debtor to grant a perfected security interest in securities, yet still keep the securities in the debtor's own name for purposes of dividends, voting, and the like. The concept of registered pledge has, however, been thought troublesome by many legal commentators and securities industry participants. For example, in Massachusetts where many mutual funds have their headquarters, a non-uniform amendment was enacted to permit the issuer of an uncertificated security to refuse to register a pledge and instead issue a certificate to the owner that the owner could then pledge by ordinary means.

Under the 1978 version of Article 8, if an issuer chose to issue securities in uncertificated form, it was also required by statute to offer a registered pledge program. Revised Articles 8 and 9 take a different approach. All of the provisions dealing with registered pledges have been deleted. This does not mean, however, that issuers cannot offer such a service. The control rules of Revised Section 8-106 and the related priority provisions in Article 9 establish a structure that permits issuers to develop systems akin to the registered pledge device, without mandating that they do so, or legislating the details of the system. In essence, the registered pledge or control device amounts to a record keeping service. A debtor can always transfer securities to its lender. In a registered pledge or control agreement arrangement, the issuer keeps track of which securities the secured party holds for its own account outright, and which securities it holds in pledge from its debtors.

Under the rules of Revised Articles 8 and 9, the registered pledge issue can easily be left to resolution by the market. The concept of control is defined in such fashion that if an issuer or securities intermediary wishes to offer a service akin to the registered pledge device it can do so. The issuer or securities intermediary would offer to enter into agreements with the debtor and secured party under which it would hold the securities for the account of the debtor, but subject to instructions from the secured party. The secured party would thereby obtain control assuring perfection and priority of its lien.

Even if such arrangements are not offered by issuers, persons who hold uncertificated securities will have several options for using them as collateral for secured loans. Under the new rules, filing is a permissible method of perfection, for debtors other than securities firms. A secured party who relies on filing is, of course, exposed to the risk that the debtor will double finance and grant a later secured lender a security interest under circumstances that give that lender control and hence priority. If the lender is unwilling to run that risk, the debtor can transfer the securities outright to the lender on the books of the issuer, though between the parties the debtor would be the owner and the lender only a secured party. That, of course, requires that the debtor trust the secured party not to dispose of the collateral wrongfully, and the debtor may also need to make arrangements with the secured party to exercise benefits of ownership such as voting and receiving distributions.

It may well be that both lenders and borrowers would prefer to have some arrangement, such as the registered pledge device of current law, that permits the debtor to remain as the registered owner entitled to vote and receive dividends but gives the lender exclusive power to order their disposition. The approach taken in this revision is that if there is a genuine demand for such arrangements, it can be met by the market. The difficulty with the approach of present Article 8 is that it mandates that any issuer that wishes to issue securities in uncertificated form must also offer this record keeping service. That obligation may well have acted as a disincentive to the development of uncertificated securities. Thus, the deletion of the mandated registered pledge provisions is consistent with the principle of neutrality toward the evolution of securities holding practices.

6. Former Section 8-403 — Issuer's Duty as to Adverse Claims.

Section 8-403 of the prior version of Article 8 dealt with the obligations of issuers to adverse claimants. The starting point of American law on issuers' liability in such circumstances is the old case of Lowry v. Commercial & Farmers' Bank, 15 F. Cas. 1040 (C.C.D. Md. 1848) (No. 8551), under which issuers could be held liable for registering a transfer at the direction of a registered owner who was acting wrongfully as against a third person in making the transfer. The Lowry principle imposed onerous liability on issuers, particularly in the case of transfers by fiduciaries, such as executors and trustees. To protect against risk of such liability, issuers developed the practice of requiring extensive documentation for fiduciary stock transfers to assure themselves that the fiduciaries were acting rightfully. As a result, fiduciary stock transfers were cumbersome and time consuming.

In the present century, American law has gradually moved away from the Lowry principle. Statutes such as the Uniform Fiduciaries Act, the Model Fiduciary Stock Transfer Act, and the Uniform Act for the Simplification of Fiduciary Security Transfers sought to avoid the delays in stock transfers that could result from issuers' demands for documentation by limiting the issuer's responsibility for transfers in breach of the registered owner's duty to others. Although these statutes provided that issuers had no duty of inquiry to determine whether a fiduciary was acting rightfully, they all provided that an issuer could be liable if the issuer acted with notice of third party claims.

The prior version of Article 8 followed the same approach as the various fiduciary transfer statutes. Issuers were not required to seek out information from which they could determine whether a fiduciary was acting properly, but they were liable if they registered a transfer with notice that the fiduciary was acting improperly. Former Section 8-308(11) said that the failure of a fiduciary to comply with a controlling instrument or failure to obtain a court approval required under local law did not render the indorsement or instruction unauthorized. However, if a fiduciary was in fact acting improperly, then the beneficiary would be treated as an adverse claimant. See Section 8-302(2) (1978) and Comment 4. Former Section 8-403 specified that if written notice of an adverse claim had been sent to the issuer, the issuer "shall inquire into the adverse claim" before registering a transfer on the indorsement or instruction of the registered owner. The issuer could "discharge any duty of inquiry by any reasonable means," including by notifying the adverse claimant that the transfer would be registered unless the adverse claimant obtained a court order or gave an indemnity bond.

Revised Article 8 rejects the Lowry principle altogether. It provides that an issuer is not liable for wrongful registration if it acts on an effective indorsement or instruction, even though the issuer may have notice of adverse claims, so long as the issuer has not been served with legal process and is not acting in collusion with the wrongdoer in registering the transfer. See Revised Section 8-404 and Comments thereto. The provisions of prior Section 8-403 specifying that issuers had a duty to investigate adverse claims of which they had notice are deleted.

Revised Article 8 also deletes the provisions set out in Section 8-403(3) of prior law specifying that issuers did not have a duty to inquire into the rightfulness of transfers by fiduciaries. The omission of the rules formerly in Section 8-403(3) does not, of course, mean that issuers would be liable for acting on the instruction of fiduciaries in the circumstances covered by former Section 8-403(3). Former Section 8-403(3) assumed that issuers would be liable if they registered a transfer with notice of an adverse claim. Former Section 8-403(3) was necessary only to negate any inference that knowledge that a transfer was initiated by a fiduciary might give constructive notice of adverse claims. Under Section 8-404 of Revised Article 8, mere notice of adverse claims does not impose duties on the issuer. Accordingly the provisions included in former Section 8-403(3) are unnecessary.

Although the prior version of Article 8 included provisions similar or identical to those set out in the Uniform Act for the Simplification of Fiduciary Security Transfers and similar statutes, most states retained these statutes at the time the Uniform Commercial Code was adopted. These statutes are based on a premise different from Revised Article 8. The fiduciary simplification acts are predicated on the assumption that an issuer would be liable to an adverse claimant if the issuer had notice. These statutes seek only to preclude any inference that issuers have such notice when they register transfers on the instructions of a fiduciary. Revised Article 8

is based on the view that a third party should not be able to interfere with the relationship between an issuer and its registered shareholders unless the claimant obtains legal process. Since notice of an adverse claim does not impose duties on an issuer under Revised Article 8, the Uniform Act for the Simplification of Fiduciary Security Transfers, or similar statutes, should be repealed upon enactment of Revised Article 8.

7. Former Section 8-319 — Statute of Frauds.

Revised Article 8 deletes the special statute of frauds provision for securities contracts that was set out in former Section 8-319. See Revised Section 8-113. Most of the litigation involving the statute of frauds rule of the prior version of Article 8 involved informal transactions, rather than transactions on the organized securities markets. Typical cases were those in which an employee or former employee of a small enterprise sued to enforce an alleged promise that he or she would receive an equity interest in the business. The usual commercial policies relating to writings in contracts for the sale of personal property are at most tangentially implicated in such cases. There was a rather large and complex body of case law dealing with the applicability of Section 8-319 to cases of this sort. It seems doubtful that the cost of litigating these issues was warranted by whatever protections the statute of frauds offered against fraudulent claims.

Subsection (c) of former Section 8-319 provided that the statute of frauds bar did not apply if a written confirmation was sent and the recipient did not seasonably send an objection. That provision, however, presumably would not have had the effect of binding a broker's customer to the terms of a trade for which confirmation had been sent though the customer had not objected within 10 days. In the first place, the relationship between a broker and customer is ordinarily that of agent and principal; thus the broker is not seeking to enforce a contract for sale of a security, but to bind its principal for action taken by the broker as agent. Former Section 8-319 did not by its terms apply to the agency relationship. Moreover, even if former Section 8-319(c) applied, it is doubtful that it, of its own force, had the effect of precluding the customer from disputing whether there was a contract or what the terms of the contract were. Former Section 8-319(c) only removed the statute of frauds as a bar to enforcement; it did not say that there was a contract or that the confirmation had the effect of excluding other evidence of its terms. Thus, deletion of former Section 8-319 does not change the law one way or the other on whether a customer who fails to object to a written confirmation is precluded from denying the trade described in the confirmation, because that issue was never governed by former Section 8-319(c).

8. Miscellaneous.

Prior Section 8-105. Revised Article 8 deletes the statement found in Section 8-105(1) of the prior version that certificated securities "are negotiable instruments." This provision was added very late in the drafting process of the original Uniform Commercial Code. Apparently the thought was that it might be useful in dealing with potential transition problems arising out of the fact that bonds were then treated as negotiable instruments under the Uniform Negotiable Instruments Law. During that era, many other statutes, such as those specifying permissible categories of investments for regulated entities, might have used such phrases as "negotiable securities" or "negotiable instruments." Section 8-105 seems to have been included in the original version of Article 8 to avoid unfortunate interpretations of those other statutes once securities were moved from the Uniform Negotiable Instruments Law to UCC Article 8. Whether or not Section 8-105 was necessary at that time, it has surely outlived its purpose. The statement that securities "are negotiable instruments" is very confusing. As used in the Uniform Commercial Code, the term "negotiable instrument" means an instrument that is governed by Article 3; yet Article 8 securities are not governed by Article 3. Courts have occasionally cited Section 8-105(1) of prior law for the proposition that the rules that are generally thought of as characteristic of negotiability, such as the rule that bona fide purchasers take free from adverse claims, apply to certificated securities. Section 8-105(1), however, is unnecessary for that purpose, since the relevant rules are set out in specific provisions of Article 8.

Prior Sections 8-107 and 8-314. Article 8 has never been, and should not be, a comprehensive codification of the law of contracts for the purchase and sale of securities. The prior version of Article 8 did contain, however, a number of provisions dealing with miscellaneous aspects of the law of contracts as applied to contracts for the sale of securities. Section 8-107 dealt with one remedy for breach, and Section 8-314 dealt with certain aspects of performance. Revised Article 8 deletes these on the theory that inclusion of a few sections on issues of contract law is likely to cause more harm than good since inferences might be drawn from the failure to cover related issues. The deletion of these sections is not, however, intended as a rejection of the rules of contract law and interpretation that they expressed.

Prior Section 8-315. It is not entirely clear what the function of Section 8-315 of prior law was. The section specified that the owner of a security could recover it from a person to whom it had been transferred, if the transferee did not qualify as a bona fide purchaser. It seems to have been intended only to recognize that securities, like any other form of personal property, are

governed by the general principle of property law that an owner can recover property from a person to whom it has been transferred under circumstances that did not cut off the owner's claim. Although many other Articles of the UCC deal with cut-off rules, Article 8 was the only one that included an affirmative statement of the rights of an owner to recover her property. It seems wiser to adopt the same approach as in Articles 2, 3, 7, and 9, and leave this point to other law. Accordingly, Section 8-315 is deleted in Revised Article 8, without, of course, implying rejection of the nearly self-evident rule that it sought to express.

Prior Section 8-407. This section, entitled "Exchangeability of Securities," seemed to say that holders of securities had the right to cause issuers to convert them back and forth from certificated to uncertificated form. The provision, however, applied only if the issuer "regularly maintains a system for issuing the class of securities involved under which both certificated and uncertificated securities are regularly issued to the category of owners, which includes the person in whose name the new security is to be registered." The provision seems unnecessary, since it applied only if the issuer decided that it should. The matter can be covered by agreement or corporate charter or by-laws.

V. ACKNOWLEDGMENTS

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Preceding the preparation of Revised Article 8, the topic was carefully studied by the Advisory Committee on Settlement of Market Transactions of the American Bar Association Section of Business Law, under the chairmanship of Robert Haydock, Jr., of Boston, MA. Martin Aronstein, of Philadelphia, PA, reporter for the 1977 revision of Article 8, served on the Haydock Committee and continued to advise the Drafting Committee. Robert C. Mendelson, New York, NY, who also served on the Haydock Committee, is chair of the Market Transactions Advisory Committee set up by the Securities and Exchange Commission; Bob Mendelson's considerable contribution to the preparation of Revised Article 8 was most important. Other members of the Haydock Committee had continuing roles either as members of the Drafting Committee or as sources of valuable advice to that committee.

The revision of Article 8 is the culmination of a successful federal-state collaboration among the American Law Institute and the National Conference of Commissioners on Uniform State Laws, sponsors of the Uniform Commercial Code, and representatives of the United States Department of the Treasury, the Securities and Exchange Commission, the Federal Reserve System, and other federal bodies. The product reflects the assistance of many people, and particularly of Jonathan Kallman and Ari Burstein on behalf of the SEC, Calvin Ninomiya, Cynthia E. Reese, and Virginia S. Rutledge of Treasury, Lawranne Stewart of the Board of Governors of the Federal Reserve System, Debra W. Cook and MarySue Fisher of the Federal Reserve Bank of New York, and George Wilder and Carla Behnfeldt of the Commodity Futures Trading Commission.

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PART 1

SHORT TITLE AND GENERAL MATTERS

4-8-101. Short title. This article may be cited as "Uniform Commercial Code - Investment Securities".

Source: L. 96: Entire article R&RE, p. 202, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-101 as it existed prior to 1996.

ANNOTATION

Law reviews. For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Article 8 provides special rules for investment securities, which are meant to ensure rapid and effective negotiation of such instruments. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

This article governs acquisition of legal ownership of certificated shares of a corporation and generally requires that a purchaser receive the security certificate or certified stock of the corporation. Mortgage Invs. Corp. v. Battle Mountain Corp., 70 P.3d 1176 (Colo. 2003).

4-8-102. Definitions. (a) In this article:

(1) "Adverse claim" means a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer, or deal with the financial asset.

(2) "Bearer form", as applied to a certificated security, means a form in which the security is payable to the bearer of the security certificate according to its terms but not by reason of an indorsement.

(3) "Broker" means a person defined as a broker or dealer under the federal securities laws, but without excluding a bank acting in that capacity.

(4) "Certificated security" means a security that is represented by a certificate.

(5) "Clearing corporation" means:

(i) A person that is registered as a "clearing agency" under the federal securities laws;

(ii) A federal reserve bank; or

(iii) Any other person that provides clearance or settlement services with respect to financial assets that would require it to register as a clearing agency under the federal securities laws but for an exclusion or exemption from the registration requirement, if its activities as a clearing corporation, including promulgation of rules, are subject to regulation by a federal or state governmental authority.

(6) "Communicate" means to:

(i) Send a signed writing; or

(ii) Transmit information by any mechanism agreed upon by the persons transmitting and receiving the information.

(7) "Entitlement holder" means a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary. If a person acquires a security entitlement by virtue of section 4-8-501 (b) (2) or (b) (3), that person is the entitlement holder.

(8) "Entitlement order" means a notification communicated to a securities intermediary directing transfer or redemption of a financial asset to which the entitlement holder has a security entitlement.

(9) "Financial asset," except as otherwise provided in section 4-8-103, means:

(i) A security;

(ii) An obligation of a person or a share, participation, or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on

financial markets, or which is recognized in any area in which it is issued or dealt in as a medium for investment; or

(iii) Any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this article. As context requires, the term means either the interest itself or the means by which a person's claim to it is evidenced, including a certificated or uncertificated security, a security certificate, or a security entitlement.

(10) "Good faith," for purposes of the obligation of good faith in the performance or enforcement of contracts or duties within this article, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(11) "Indorsement" means a signature that alone or accompanied by other words is made on a security certificate in registered form or on a separate document for the purpose of assigning, transferring, or redeeming the security or granting a power to assign, transfer, or redeem it.

(12) "Instruction" means a notification communicated to the issuer of an uncertificated security which directs that the transfer of the security be registered or that the security be redeemed.

(13) "Registered form," as applied to a certificated security, means a form in which:

(i) The security certificate specifies a person entitled to the security; and

(ii) A transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security certificate so states.

(14) "Securities intermediary" means:

(i) A clearing corporation; or

(ii) A person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.

(15) "Security," except as otherwise provided in section 4-8-103, means an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:

(i) Which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;

(ii) Which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and

(iii) Which:

(A) Is, or is of a type, dealt in or traded on securities exchanges or securities markets; or

(B) Is a medium for investment and by its terms expressly provides that it is a security governed by this article.

(16) "Security certificate" means a certificate representing a security.

(17) "Security entitlement" means the rights and property interest of an entitlement holder with respect to a financial asset specified in part 5 of this article.

(18) "Uncertificated security" means a security that is not represented by a certificate.

(b) Other definitions applying to this article and the sections in which they appear are:

Appropriate person	Section 4-8-107
Control	Section 4-8-106
Delivery	Section 4-8-301
Investment company security	Section 4-8-103
Issuer	Section 4-8-201
Overissue	Section 4-8-210
Protected purchaser	Section 4-8-303
Securities account	Section 4-8-501

(c) In addition, article 1 of this title contains general definitions and principles of construction and interpretation applicable throughout this article.

(d) The characterization of a person, business, or transaction for purposes of this article does not determine the characterization of the person, business, or transaction for purposes of any other law, regulation, or rule.

Source: L. 96: Entire article R&RE, p. 202, § 2, effective July 1.

Editor's note: This section is similar to former §§ 4-8-102, 4-8-302, 4-8-303, 4-8-308, and 4-8-313 as they existed prior to 1996.

OFFICIAL COMMENT

1. "Adverse claim." The definition of the term "adverse claim" has two components. First, the term refers only to property interests. Second, the term means not merely that a person has a property interest in a financial asset but that it is a violation of the claimant's property interest for the other person to hold or transfer the security or other financial asset.

The term adverse claim is not, of course, limited to ownership rights, but extends to other property interests established by other law. A security interest, for example, would be an adverse claim with respect to a transferee from the debtor since any effort by the secured party to enforce the security interest against the property would be an interference with the transferee's interest.

The definition of adverse claim in the prior version of Article 8 might have been read to suggest that any wrongful action concerning a security, even a simple breach of contract, gave rise to an adverse claim. Insofar as such cases as Fallon v. Wall Street Clearing Corp., 586 N.Y.S.2d 953, 182 A.D.2d 245, (1992) and Pentech Intl. v. Wall St. Clearing Co., 983 F.2d 441 (2d Cir. 1993), were based on that view, they are rejected by the new definition which explicitly limits the term adverse claim to property interests. Suppose, for example, that A contracts to sell or deliver securities to B, but fails to do so and instead sells or pledges the securities to C. B, the promisee, has an action against A for breach of contract, but absent unusual circumstances the action for breach would not give rise to a property interest in the securities. Accordingly, B does not have an adverse claim. An adverse claim might, however, be based upon principles of equitable remedies that give rise to property claims. It would, for example, cover a right established by other law to rescind a transaction in which securities were transferred. Suppose, for example, that A holds securities and is induced by B's fraud to transfer them to B. Under the law of contract or restitution, A may have a right to rescind the transfer, which gives A a property claim to the securities. If so, A has an adverse claim to the securities in B's hands. By contrast, if B had committed no fraud, but had merely committed a breach of contract in connection with the transfer from A to B, A may have only a right to damages for breach, not a right to rescind. In that case, A would not have an adverse claim to the securities in B's hands.

2. "Bearer form." The definition of "bearer form" has remained substantially unchanged since the early drafts of the original version of Article 8. The requirement that the certificate be payable to bearer by its terms rather than by an indorsement has the effect of preventing instruments governed by other law, such as chattel paper or Article 3 negotiable instruments, from being inadvertently swept into the Article 8 definition of security merely by virtue of blank indorsements. Although the other elements of the definition of security in Section 8-102(a)(14) probably suffice for that purpose in any event, the language used in the prior version of Article 8 has been retained.

3. "Broker." Broker is defined by reference to the definitions of broker and dealer in the federal securities laws. The only difference is that banks, which are excluded from the federal securities law definition, are included in the Article 8 definition when they perform functions that would bring them within the federal securities law definition if it did not have the clause excluding banks. The definition covers both those who act as agents ("brokers" in securities parlance) and those who act as principals ("dealers" in securities parlance). Since the definition refers to persons "defined" as brokers or dealers under the federal securities law, rather than to persons required to "register" as brokers or dealers under the federal securities law, it covers not only registered brokers and dealers but also those exempt from the registration requirement, such as purely intrastate brokers. The only substantive rules that turn on the defined term broker are one provision of the section on warranties, Section 8-108(i), and the special perfection rule in Article 9 for security interests granted by brokers, Section 9-115(4)(c).

4. "Certificated security." The term "certificated security" means a security that is represented by a security certificate.

5. "Clearing corporation." The definition of clearing corporation limits its application to entities that are subject to a rigorous regulatory framework. Accordingly, the definition includes only federal reserve banks, persons who are registered as "clearing agencies" under the federal securities laws (which impose a comprehensive system of regulation of the activities and rules of clearing agencies), and other entities subject to a comparable system of regulatory oversight.

6. "Communicate." The term "communicate" assures that the Article 8 rules will be sufficiently flexible to adapt to changes in information technology. Sending a signed writing

always suffices as a communication, but the parties can agree that a different means of transmitting information is to be used. Agreement is defined in Section 1-201(3) as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance." Thus, use of an information transmission method might be found to be authorized by agreement, even though the parties have not explicitly so specified in a formal agreement. The term communicate is used in Sections 8-102(a)(7) (definition of entitlement order), 8-102(a)(11) (definition of instruction), and 8-403 (demand that issuer not register transfer).

7. "Entitlement holder." This term designates those who hold financial assets through intermediaries in the indirect holding system. Because many of the rules of Part 5 impose duties on securities intermediaries in favor of entitlement holders, the definition of entitlement holder is, in most cases, limited to the person specifically designated as such on the records of the intermediary. The last sentence of the definition covers the relatively unusual cases where a person may acquire a security entitlement under Section 8-501 even though the person may not be specifically designated as an entitlement holder on the records of the securities intermediary.

A person may have an interest in a security entitlement, and may even have the right to give entitlement orders to the securities intermediary with respect to it, even though the person is not the entitlement holder. For example, a person who holds securities through a securities account in its own name may have given discretionary trading authority to another person, such as an investment adviser. Similarly, the control provisions in Section 8-106 and the related provisions in Article 9 are designed to facilitate transactions in which a person who holds securities through a securities account uses them as collateral in an arrangement where the securities intermediary has agreed that if the secured party so directs the intermediary will dispose of the positions. In such arrangements, the debtor remains the entitlement holder but has agreed that the secured party can initiate entitlement orders.

8. "Entitlement order." This term is defined as a notification communicated to a securities intermediary directing transfer or redemption of the financial asset to which an entitlement holder has a security entitlement. The term is used in the rules for the indirect holding system in a fashion analogous to the use of the terms "indorsement" and "instruction" in the rules for the direct holding system. If a person directly holds a certificated security in registered form and wishes to transfer it, the means of transfer is an indorsement. If a person directly holds an uncertificated security and wishes to transfer it, the means of transfer is an instruction. If a person holds a security entitlement, the means of disposition is an entitlement order. As noted in Comment 7, an entitlement order need not be initiated by the entitlement holder in order to be effective, so long as the entitlement holder has authorized the other party to initiate entitlement orders. See Section 8-107(b).

9. "Financial asset." The definition of "financial asset," in conjunction with the definition of "securities account" in Section 8-501, sets the scope of the indirect holding system rules of Part 5 of Revised Article 8. The Part 5 rules apply not only to securities held through intermediaries, but also to other financial assets held through intermediaries. The term financial asset is defined to include not only securities but also a broader category of obligations, shares, participations, and interests.

Having separate definitions of security and financial asset makes it possible to separate the question of the proper scope of the traditional Article 8 rules from the question of the proper scope of the new indirect holding system rules. Some forms of financial assets should be covered by the indirect holding system rules of Part 5, but not by the rules of Parts 2, 3, and 4. The term financial asset is used to cover such property. Because the term security entitlement is defined in terms of financial assets rather than securities, the rules concerning security entitlements set out in Part 5 of Article 8 and in Revised Article 9 apply to the broader class of financial assets.

The fact that something does or could fall within the definition of financial asset does not, without more, trigger Article 8 coverage. The indirect holding system rules of Revised Article 8 apply only if the financial asset is in fact held in a securities account, so that the interest of the person who holds the financial asset through the securities account is a security entitlement. Thus, questions of the scope of the indirect holding system rules cannot be framed as "Is such-and-such a 'financial asset' under Article 8?" Rather, one must analyze whether the relationship between an institution and a person on whose behalf the institution holds an asset falls within the scope of the term securities account as defined in Section 8-501. That question turns in large measure on whether it makes sense to apply the Part 5 rules to the relationship.

The term financial asset is used to refer both to the underlying asset and the particular means by which ownership of that asset is evidenced. Thus, with respect to a certificated security, the term financial asset may, as context requires, refer either to the interest or obligation of the issuer or to the security certificate representing that interest or obligation. Similarly, if a person holds a security or other financial asset through a securities account, the term financial asset may, as context requires, refer either to the

underlying asset or to the person's security entitlement.

10. "Good faith." Good faith is defined in Article 8 for purposes of the application to Article 8 of Section 1-203, which provides that "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." The sole function of the good faith definition in Revised Article 8 is to give content to the Section 1-203 obligation as it applies to contracts and duties that are governed by Article 8. The standard is one of "reasonable commercial standards of fair dealing." The reference to commercial standards makes clear that assessments of conduct are to be made in light of the commercial setting. The substantive rules of Article 8 have been drafted to take account of the commercial circumstances of the securities holding and processing system. For example, Section 8-115 provides that a securities intermediary acting on an effective entitlement order, or a broker or other agent acting as a conduit in a securities transaction, is not liable to an adverse claimant, unless the claimant obtained legal process or the intermediary acted in collusion with the wrongdoer. This, and other similar provisions, see Sections 8-404 and 8-503(e), do not depend on notice of adverse claims, because it would impair rather than advance the interest of investors in having a sound and efficient securities clearance and settlement system to require intermediaries to investigate the propriety of the transactions they are processing. The good faith obligation does not supplant the standards of conduct established in provisions of this kind.

In Revised Article 8, the definition of good faith is not germane to the question whether a purchaser takes free from adverse claims. The rules on such questions as whether a purchaser who takes in suspicious circumstances is disqualified from protected purchaser status are treated not as an aspect of good faith but directly in the rules of Section 8-105 on notice of adverse claims.

11. "Indorsement" is defined as a signature made on a security certificate or separate document for purposes of transferring or redeeming the security. The definition is adapted from the language of Section 8-308(1) of the prior version and from the definition of indorsement in the Negotiable Instruments Article, see Section 3-204(a). The definition of indorsement does not include the requirement that the signature be made by an appropriate person or be authorized. Those questions are treated in the separate substantive provision on whether the indorsement is effective, rather than in the definition of indorsement. See Section 8-107.

12. "Instruction" is defined as a notification communicated to the issuer of an uncertificated security directing that transfer be registered or that the security be redeemed. Instructions are the analog for uncertificated securities of indorsements of certificated securities.

13. "Registered form." The definition of "registered form" is substantially the same as in the prior version of Article 8. Like the definition of bearer form, it serves primarily to distinguish Article 8 securities from instruments governed by other law, such as Article 3.

[Contrary to the holding in *Highland Capital Management LP v. Schneider,* 8 N.Y.3d 406 (2007), the registrability requirement in the definition of "registered form," and its parallel in the definition of "security," are satisfied only if books are maintained by or on behalf of the issuer for the purpose of registration of transfer, including the determination of rights under Section 8-207(a) (or if, in the case of a certificated security, the security certificate so states). It is not sufficient that the issuer records ownership, or records transfers thereof, for other purposes. Nor is it sufficient that the issuer, while not in fact maintaining books for the purpose of registration of transfer, could do so, for such is always the case.]

Note: The bracketed language is effective July 1, 2013.

14. "Securities intermediary." A "securities intermediary" is a person that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity. The most common examples of securities intermediaries would be clearing corporations holding securities for their participants, banks acting as securities custodians, and brokers holding securities on behalf of their customers. Clearing corporations are listed separately as a category of securities intermediary in subparagraph (i) even though in most circumstances they would fall within the general definition in subparagraph (ii). The reason is to simplify the analysis of arrangements such as the NSCC-DTC system in which NSCC performs the comparison, clearance, and netting function, while DTC acts as the depository. Because NSCC is a registered clearing agency under the federal securities laws, it is a clearing corporation and hence a securities intermediary under Article 8, regardless of whether it is at any particular time or in any particular aspect of its operations holding securities on behalf of its participants.

The terms securities intermediary and broker have different meanings. Broker means a person engaged in the business of buying and selling securities, as agent for others or as principal. Securities intermediary means a person maintaining securities accounts for others. A stockbroker, in the colloquial sense, may or may not be acting as a securities intermediary.

The definition of securities intermediary includes the requirement that the person in question is "acting in the capacity" of maintaining securities accounts for others. This is to take account of the fact that a particular entity, such

as a bank, may act in many different capacities in securities transactions. A bank may act as a transfer agent for issuers, as a securities custodian for institutional investors and private investors, as a dealer in government securities, as a lender taking securities as collateral, and as a provider of general payment and collection services that might be used in connection with securities transactions. A bank that maintains securities accounts for its customers would be a securities intermediary with respect to those accounts; but if it takes a pledge of securities from a borrower to secure a loan, it is not thereby acting as a securities intermediary with respect to the pledged securities, since it holds them for its own account rather than for a customer. In other circumstances, those two functions might be combined. For example, if the bank is a government securities dealer it may maintain securities accounts for customers and also provide the customers with margin credit to purchase or carry the securities, in much the same way that brokers provide margin loans to their customers.

15. "Security." The definition of "security" has three components. First, there is the subparagraph (i) test that the interest or obligation be fully transferable, in the sense that the issuer either maintains transfer books or the obligation or interest is represented by a certificate in bearer or registered form. Second, there is the subparagraph (ii) test that the interest or obligation be divisible, that is, one of a class or series, as distinguished from individual obligations of the sort governed by ordinary contract law or by Article 3. Third, there is the subparagraph (iii) functional test, which generally turns on whether the interest or obligation is, or is of a type, dealt in or traded on securities markets or securities exchanges. There is, however, an "opt-in" provision in subparagraph (iii) which permits the issuer of any interest or obligation that is "a medium of investment" to specify that it is a security governed by Article 8.

The divisibility test of subparagraph (ii) applies to the security — that is, the underlying intangible interest — not the means by which that interest is evidenced. Thus, securities issued in book-entry only form meet the divisibility test because the underlying intangible interest is divisible via the mechanism of the indirect holding system. This is so even though the clearing corporation is the only eligible direct holder of the security.

The third component, the functional test in subparagraph (iii), provides flexibility while ensuring that the Article 8 rules do not apply to interests or obligations in circumstances so unconnected with the securities markets that parties are unlikely to have thought of the possibility that Article 8 might apply. Subparagraph (iii)(A) covers interests or obligations that either are dealt in or traded on securities exchanges or securities markets, or are of a type dealt in or traded on securities exchanges or securities markets. The "is dealt in or traded on" phrase eliminates problems in the characterization of new forms of securities which are to be traded in the markets, even though no similar type has previously been dealt in or traded in the markets. Subparagraph (iii)(B) covers the broader category of media for investment, but it applies only if the terms of the interest or obligation specify that it is an Article 8 security. This opt-in provision allows for deliberate expansion of the scope of Article 8.

Section 8-103 contains additional rules on the treatment of particular interests as securities or financial assets.

16. "Security certificate." The term "security" refers to the underlying asset, e.g., 1000 shares of common stock of Acme, Inc. The term "security certificate" refers to the paper certificates that have traditionally been used to embody the underlying intangible interest.

17. "Security entitlement" means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary. A security entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary. A security entitlement is not, however, a specific property interest in any financial asset held by the securities intermediary or by the clearing corporation through which the securities intermediary holds the financial asset. See Sections 8-104(c) and 8-503. The formal definition of security entitlement set out in subsection (a)(17) of this section is a cross-reference to the rules of Part 5. In a sense, then, the entirety of Part 5 is the definition of security entitlement. The Part 5 rules specify the rights and property interest that comprise a security entitlement.

18. "Uncertificated security." The term "uncertificated security" means a security that is not represented by a security certificate. For uncertificated securities, there is no need to draw any distinction between the underlying asset and the means by which a direct holder's interest in that asset is evidenced. Compare "certificated security" and "security certificate."

Definitional Cross References:

"Agreement". Section 1-201(3)
"Bank". Section 1-201(4)
"Person". Section 1-201(30)
"Send". Section 1-201(38)
"Signed". Section 1-201(39)
"Writing". Section 1-201(46)

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Claim to limited tax bond rose to the level of a "property interest" sufficient to constitute an adverse claim. Meadow Homes Dev. Corp. v. Bowens, 211 P.3d 743 (Colo. App. 2009).

Absent unusual circumstances, a simple breach of contract does not itself establish a property interest required for an adverse claim to be a security. An adverse claim may, however, be based on principles of equitable remedies that give rise to property claims. Meadow Homes Dev. Corp. v. Bowens, 211 P.3d 743 (Colo. App. 2009).

Unusual circumstances entitled claimant to equitable remedies where seller of bond did more than simply breach a contract. Seller acted in a fraudulent manner intended to hinder and defraud the rights of the claimant. In addition, the bond was not a fungible investment security but rather was created as part of a land development project and ownership of the bond pivoted on which party ultimately bought and developed the land. Meadow Homes Dev. Corp. v. Bowens, 211 P.3d 743 (Colo. App. 2009).

Applied in Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

4-8-103. Rules for determining whether certain obligations and interests are securities or financial assets. (a) A share or similar equity interest issued by a corporation, business trust, joint stock company, or similar entity is a security.

(b) An "investment company security" is a security. "Investment company security" means a share or similar equity interest issued by an entity that is registered as an investment company under the federal investment company laws, an interest in a unit investment trust that is so registered, or a face-amount certificate issued by a face-amount certificate company that is so registered. Investment company security does not include an insurance policy or endowment policy or annuity contract issued by an insurance company.

(c) An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by this article, or it is an investment company security. However, an interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

(d) A writing that is a security certificate is governed by this article and not by article 3 of this title, even though it also meets the requirements of that article. However, a negotiable instrument governed by article 3 of this title is a financial asset if it is held in a securities account.

(e) An option or similar obligation issued by a clearing corporation to its participants is not a security, but is a financial asset.

(f) A commodity contract, as defined in section 4-9-102 (a) (15), is not a security or a financial asset.

(g) A document of title is not a financial asset unless section 4-8-102 (a) (9) (iii) applies.

Source: L. 96: Entire article R&RE, p. 205, § 2, effective July 1. **L. 2001:** (f) amended, p. 1442, § 30, effective July 1. **L. 2006:** (g) added, p. 498, § 32, effective September 1. **L. 2007:** (g) amended, p. 375, § 29, effective August 3.

OFFICIAL COMMENT

1. This section contains rules that supplement the definitions of "financial asset" and "security" in Section 8-102. The Section 8-102 definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in this section are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the Section 8-102 definitions to investment products not covered by this section.

2. Subsection (a) establishes an unconditional rule that ordinary corporate stock is a security. That is so whether or not the particular issue is dealt in or traded on securities exchanges or in securities markets. Thus, shares of closely held corporations are Article 8 securities.

3. Subsection (b) establishes that the Article 8 term "security" includes the various forms of the investment vehicles offered to the public by investment companies registered as such under the federal Investment Company Act of 1940, as amended. This clarification is prompted principally by the fact that the typical transaction in shares of open-end investment companies is an issuance or redemption, rather than a transfer of shares from one person to another as is the case with ordinary corporate stock. For similar reasons, the definitions of indorsement, instruction, and entitlement order in Section 8-102 refer to "redemptions" as well as "transfers," to ensure that the Article 8 rules on such matters as signature guaranties, Section 8-306, assurances, Sections 8-402 and 8-507, and effectiveness, Section 8-107, apply to directions to redeem mutual fund shares. The exclusion of insurance products is needed because some insurance company separate accounts are registered under the Investment Company Act of 1940, but these are not traded under the usual Article 8 mechanics.

4. Subsection (c) is designed to foreclose interpretive questions that might otherwise be raised by the application of the "of a type" language of Section 8-102(a)(15)(iii) to partnership interests. Subsection (c) establishes the general rule that partnership interests or shares of limited liability companies are not Article 8 securities unless they are in fact dealt in or traded on securities exchanges or in securities markets. The issuer, however, may explicitly "opt-in" by specifying that the interests or shares are securities governed by Article 8. Partnership interests or shares of limited liability companies are included in the broader term "financial asset." Thus, if they are held through a securities account, the indirect holding system rules of Part 5 apply, and the interest of a person who holds them through such an account is a security entitlement.

5. Subsection (d) deals with the line between Article 3 negotiable instruments and Article 8 investment securities. It continues the rule of the prior version of Article 8 that a writing that meets the Article 8 definition is covered by Article 8 rather than Article 3, even though it also meets the definition of negotiable instrument. However, subsection (d) provides that an Article 3 negotiable instrument is a "financial asset" so that the indirect holding system rules apply if the instrument is held through a securities intermediary. This facilitates making items such as money market instruments eligible for deposit in clearing corporations.

6. Subsection (e) is included to clarify the treatment of investment products such as traded stock options, which are treated as financial assets but not securities. Thus, the indirect holding system rules of Part 5 apply, but the direct holding system rules of Parts 2, 3, and 4 do not.

7. Subsection (f) excludes commodity contracts from all of Article 8. However, the Article 9 rules on security interests in investment property do apply to security interests in commodity positions. See Section 9-115 and Comment 8 thereto. "Commodity contract" is defined in Section 9-115.

Definitional Cross References:

"Clearing corporation". Section 8-102(a)(5)
"Commodity contract". Section 9-115
"Financial asset". Section 8-102(a)(9)
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)

4-8-104. Acquisition of security or financial asset or interest therein. (a) A person acquires a security or an interest therein, under this article, if:

(1) The person is a purchaser to whom a security is delivered pursuant to section 4-8-301; or

(2) The person acquires a security entitlement to the security pursuant to section 4-8-501.

(b) A person acquires a financial asset, other than a security, or an interest therein, under this article, if the person acquires a security entitlement to the financial asset.

(c) A person who acquires a security entitlement to a security or other financial asset has the rights specified in part 5 of this article, but is a purchaser of any security, security entitlement, or other financial asset held by the securities intermediary only to the extent provided in section 4-8-503.

(d) Unless the context shows that a different meaning is intended, a person who is required by other law, regulation, rule, or agreement to transfer, deliver, present, surrender, exchange, or otherwise put in the possession of another person a security or financial asset satisfies that requirement by causing the other person to acquire an interest in the security or financial asset pursuant to subsection (a) or (b) of this section.

Source: L. 96: Entire article R&RE, p. 206, § 2, effective July 1.

OFFICIAL COMMENT

1. This section lists the ways in which interests in securities and other financial assets are acquired under Article 8. In that sense, it describes the scope of Article 8. Subsection (a) describes the two ways that a person may acquire a security or interest therein under this Article: (1) by delivery (Section 8-301), and (2) by acquiring a security entitlement. Each of these methods is described in detail in the relevant substantive provisions of this Article. Part 3, beginning with the definition of "delivery" in Section 8-301, describes how interests in securities are acquired in the direct holding system. Part 5, beginning with the rules of Section 8-501 on how security entitlements are acquired, describes how interests in securities are acquired in the indirect holding system.

Subsection (b) specifies how a person may acquire an interest under Article 8 in a financial asset other than a security. This Article deals with financial assets other than securities only insofar as they are held in the indirect holding system. For example, a bankers' acceptance falls within the definition of "financial asset," so if it is held through a securities account the entitlement holder's right to it is a security entitlement governed by Part 5. The bankers' acceptance itself, however, is a negotiable instrument governed by Article 3, not by Article 8. Thus, the provisions of Parts 2, 3, and 4 of this Article that deal with the rights of direct holders of securities are not applicable. Article 3, not Article 8, specifies how one acquires a direct interest in a bankers' acceptance. If a bankers' acceptance is delivered to a clearing corporation to be held for the account of the clearing corporation's participants, the clearing corporation becomes the holder of the bankers' acceptance under the Article 3 rules specifying how negotiable instruments are transferred. The rights of the clearing corporation's participants, however, are governed by Part 5 of this Article.

2. The distinction in usage in Article 8 between the term "security" (and its correlatives "security certificate" and "uncertificated security") on the one hand, and "security entitlement" on the other, corresponds to the distinction between the direct and indirect holding systems. For example, with respect to certificated securities that can be held either directly or through intermediaries, obtaining possession of a security certificate and acquiring a security entitlement are both means of holding the underlying security. For many other purposes, there is no need to draw a distinction between the means of holding. For purposes of commercial law analysis, however, the form of holding may make a difference. Where an item of property can be held in different ways, the rules on how one deals with it, including how one transfers it or how one grants a security interest in it, differ depending on the form of holding.

Although a security entitlement is means of holding the underlying security or other financial asset, a person who has a security entitlement does not have any direct claim to a specific asset in the possession of the securities intermediary. Subsection (c) provides explicitly that a person who acquires a security entitlement is a "purchaser" of any security, security entitlement, or other financial asset held by the securities intermediary only in the sense that under Section 8-503 a security entitlement is treated as a sui generis form of property interest.

3. Subsection (d) is designed to ensure that parties will retain their expected legal rights and duties under Revised Article 8. One of the major changes made by the revision is that the rules for the indirect holding system are stated in terms of the "security entitlements" held by investors, rather than speaking of them as holding direct interests in securities. Subsection (d) is designed as a translation rule to eliminate problems of co-ordination of terminology, and facilitate the continued use of systems for the efficient handling of securities and financial assets through securities intermediaries and clearing corporations. The efficiencies of a securities intermediary or clearing corporation are, in part, dependent on the ability to transfer securities credited to securities accounts in the intermediary or clearing corporation to the account of an issuer, its agent, or other person by book entry in a manner that permits exchanges, redemptions, conversions, and other transactions (which may be governed by pre-existing or new agreements, constitutional documents, or other instruments) to occur and to avoid the need to withdraw from immobilization in an intermediary or clearing corporation physical securities in order to deliver them for such purposes. Existing corporate charters, indentures and like documents may require the "presentation," "surrender," "delivery," or "transfer" of securities or security certificates for purposes of exchange, redemption, conversion or other reason. Likewise, documents may use a wide variety of terminology to describe, in the context for example of a tender or exchange offer, the means of putting the offeror or the issuer or its agent in possession of the security. Subsection (d) takes the place of provisions of prior law which could be used to reach the legal conclusion that book-entry transfers are equivalent to physical delivery to the person to whose account the book entry is credited.

Definitional Cross References:

"Delivery". Section 8-301

"Financial asset". Section 8-102(a)(9)

"Person". Section 1-201(30)
"Purchaser". Sections 1-201(33) & 8-116
"Security". Section 8-102(a)(15)
"Security entitlement". Section 8-102(a)(17)

4-8-105. Notice of adverse claim. (a) A person has notice of an adverse claim if:

(1) The person knows of the adverse claim;

(2) The person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim; or

(3) The person has a duty, imposed by statute or regulation, to investigate whether an adverse claim exists, and the investigation so required would establish the existence of the adverse claim.

(b) Having knowledge that a financial asset or interest therein is or has been transferred by a representative imposes no duty of inquiry into the rightfulness of a transaction and is not notice of an adverse claim. However, a person who knows that a representative has transferred a financial asset or interest therein in a transaction that is, or whose proceeds are being used, for the individual benefit of the representative or otherwise in breach of duty has notice of an adverse claim.

(c) An act or event that creates a right to immediate performance of the principal obligation represented by a security certificate or sets a date on or after which the certificate is to be presented or surrendered for redemption or exchange does not itself constitute notice of an adverse claim except in the case of a transfer more than:

(1) One year after a date set for presentment or surrender for redemption or exchange; or

(2) Six months after a date set for payment of money against presentation or surrender of the certificate, if money was available for payment on that date.

(d) A purchaser of a certificated security has notice of an adverse claim if the security certificate:

(1) Whether in bearer or registered form, has been indorsed "for collection" or "for surrender" or for some other purpose not involving transfer; or

(2) Is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor, but the mere writing of a name on the certificate is not such a statement.

(e) Filing of a financing statement under article 9 of this title is not notice of an adverse claim to a financial asset.

Source: L. 96: Entire article R&RE, p. 207, § 2, effective July 1.

Editor's note: This section is similar to former §§ 4-8-304 and 4-8-305 as they existed prior to 1996.

OFFICIAL COMMENT

1. The rules specifying whether adverse claims can be asserted against persons who acquire securities or security entitlements, Sections 8-303, 8-502, and 8-510, provide that one is protected against an adverse claim only if one takes without notice of the claim. This section defines notice of an adverse claim.

The general Article 1 definition of "notice" in Section 1-201(25) — which provides that a person has notice of a fact if "from all the facts and circumstances known to him at the time in question he has reason to know that it exists" — does not apply to the interpretation of "notice of adverse claims." The Section 1-201(25) definition of "notice" does, however, apply to usages of that term and its cognates in Article 8 in contexts other than notice of adverse claims.

2. This section must be interpreted in light of the definition of "adverse claim" in Section 8-102(a)(1). "Adverse claim" does not include all circumstances in which a third party has a property interest in securities, but only those situations where a security is transferred in violation of the claimant's property interest. Therefore, awareness that someone other than the transferor has a property interest is not notice of an adverse claim. The transferee must be aware that the transfer violates the other party's property interest. If A holds securities in which B has some form of property interest, and A transfers the securities to C, C may know that B has an interest, but infer that A is acting in accordance with A's obligations to B. The mere fact that C knew that B had a property interest

does not mean that C had notice of an adverse claim. Whether C had notice of an adverse claim depends on whether C had sufficient awareness that A was acting in violation of B's property rights. The rule in subsection (b) is a particularization of this general principle.

3. Paragraph (a)(1) provides that a person has notice of an adverse claim if the person has knowledge of the adverse claim. Knowledge is defined in Section 1-201(25) as actual knowledge.

4. Paragraph (a)(2) provides that a person has notice of an adverse claim if the person is aware of a significant probability that an adverse claim exists and deliberately avoids information that might establish the existence of the adverse claim. This is intended to codify the "willful blindness" test that has been applied in such cases. See May v. Chapman, 16 M. & W. 355, 153 Eng. Rep. 1225 (1847); Goodman v. Simonds, 61 U.S. 343 (1857).

The first prong of the willful blindness test of paragraph (a)(2) turns on whether the person is aware facts sufficient to indicate that there is a significant probability that an adverse claim exists. The "awareness" aspect necessarily turns on the actor's state of mind. Whether facts known to a person make the person aware of a "significant probability" that an adverse claim exists turns on facts about the world and the conclusions that would be drawn from those facts, taking account of the experience and position of the person in question. A particular set of facts might indicate a significant probability of an adverse claim to a professional with considerable experience in the usual methods and procedures by which securities transactions are conducted, even though the same facts would not indicate a significant probability of an adverse claim to a non-professional.

The second prong of the willful blindness test of paragraph (a)(2) turns on whether the person "deliberately avoids information" that would establish the existence of the adverse claim. The test is the character of the person's response to the information the person has. The question is whether the person deliberately failed to seek further information because of concern that suspicions would be confirmed.

Application of the "deliberate avoidance" test to a transaction by an organization focuses on the knowledge and the actions of the individual or individuals conducting the transaction on behalf of the organization. Thus, an organization that purchases a security is not willfully blind to an adverse claim unless the officers or agents who conducted that purchase transaction are willfully blind to the adverse claim. Under the two prongs of the willful blindness test, the individual or individuals conducting a transaction must know of facts indicating a substantial probability that the adverse claim exists and deliberately fail to seek further information that might confirm or refute the indication. For this purpose, information known to individuals within an organization who are not conducting or aware of a transaction, but not forwarded to the individuals conducting the transaction, is not pertinent in determining whether the individuals conducting the transaction had knowledge of a substantial probability of the existence of the adverse claim. Cf. Section 1-201(27). An organization may also "deliberately avoid information" if it acts to preclude or inhibit transmission of pertinent information to those individuals responsible for the conduct of purchase transactions.

5. Paragraph (a)(3) provides that a person has notice of an adverse claim if the person would have learned of the adverse claim by conducting an investigation that is required by other statute or regulation. This rule applies only if there is some other statute or regulation that explicitly requires persons dealing with securities to conduct some investigation. The federal securities laws require that brokers and banks, in certain specified circumstances, check with a stolen securities registry to determine whether securities offered for sale or pledge have been reported as stolen. If securities that were listed as stolen in the registry are taken by an institution that failed to comply with requirement to check the registry, the institution would be held to have notice of the fact that they were stolen under paragraph (a)(3). Accordingly, the institution could not qualify as a protected purchaser under Section 8-303. The same result has been reached under the prior version of Article 8. See First Nat'l Bank of Cicero v. Lewco Securities, 860 F.2d 1407 (7th Cir. 1988).

6. Subsection (b) provides explicitly for some situations involving purchase from one described or identifiable as a representative. Knowledge of the existence of the representative relation is not enough in itself to constitute "notice of an adverse claim" that would disqualify the purchaser from protected purchaser status. A purchaser may take a security on the inference that the representative is acting properly. Knowledge that a security is being transferred to an individual account of the representative or that the proceeds of the transaction will be paid into that account is not sufficient to constitute "notice of an adverse claim," but knowledge that the proceeds will be applied to the personal indebtedness of the representative is. See State Bank of Binghamton v. Bache, 162 Misc. 128, 293 N.Y.S. 667 (1937).

7. Subsection (c) specifies whether a purchaser of a "stale" security is charged with notice of adverse claims, and therefore disqualified from protected purchaser status under Section 8-303. The fact of "staleness" is viewed as notice of certain defects after the lapse of stated periods, but the maturity of the security does not operate automatically to affect holders' rights.

The periods of time here stated are shorter than those appearing in the provisions of this Article on staleness as notice of defects or defenses of an issuer (Section 8-203) since a purchaser who takes a security after funds or other securities are available for its redemption has more reason to suspect claims of ownership than issuer's defenses. An owner will normally turn in a security rather than transfer it at such a time. Of itself, a default never constitutes notice of a possible adverse claim. To provide otherwise would not tend to drive defaulted securities home and would serve only to disrupt current financial markets where many defaulted securities are actively traded. Unpaid or overdue coupons attached to a bond do not bring it within the operation of this subsection, though they may be relevant under the general test of notice of adverse claims in subsection (a).

8. Subsection (d) provides the owner of a certificated security with a means of protection while a security certificate is being sent in for redemption or exchange. The owner may endorse it "for collection" or "for surrender," and this constitutes notice of the owner's claims, under subsection (d).

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1)
"Bearer form". Section 8-102(a)(2)
"Certificated security". Section 8-102(a)(4)
"Financial asset". Section 8-102(a)(9)
"Knowledge". Section 1-201(25)
"Person". Section 1-201(30)
"Purchaser". Sections 1-201(33) & 8-116
"Registered form". Section 8-102(a)(13)
"Representative". Section 1-201(35)
"Security certificate". Section 8-102(a)(16)

ANNOTATION

Purchaser of limited tax bond was not a "protected purchaser" acquiring rights greater than the seller held because purchaser had prior notice of another's adverse claim. Meadow Homes Dev. Corp. v. Bowens, 211 P.3d 743 (Colo. App. 2009).

4-8-106. Control. (a) A purchaser has "control" of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(b) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser, and:

(1) The certificate is indorsed to the purchaser or in blank by an effective indorsement; or

(2) The certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(c) A purchaser has "control" of an uncertificated security if:

(1) The uncertificated security is delivered to the purchaser; or

(2) The issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

(d) A purchaser has "control" of a security entitlement if:

(1) The purchaser becomes the entitlement holder;

(2) The securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder; or

(3) Another person has control of the security entitlement on behalf of the purchaser or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the purchaser.

(e) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(f) A purchaser who has satisfied the requirements of subsection (c) or (d) of this section has control even if the registered owner in the case of subsection (c) of this section or the entitlement holder in the case of subsection (d) of this section retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(g) An issuer or a securities intermediary may not enter into an agreement of the kind described in subsection (c) (2) or (d) (2) of this section without the consent of the registered owner or entitlement holder, but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder.

Source: L. 96: Entire article R&RE, p. 208, § 2, effective July 1. **L. 2001:** (d) and (f) amended, p. 1442, § 31, effective July 1.

Editor's note: This section is similar to former § 4-8-311 as it existed prior to 1996.

OFFICIAL COMMENT

1. The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See Sections 8-303 (protected purchasers); 8-503(e) (purchasers from securities intermediaries); 8-510 (purchasers of security entitlements from entitlement holders); 9-115(4) (perfection of security interests); 9-115(5) (priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

2. Subsection (a) provides that a purchaser obtains "control" with respect to a certificated security in bearer form by taking "delivery," as defined in Section 8-301. Subsection (b) provides that a purchaser obtains "control" with respect to a certificated security in registered form by taking "delivery," as defined in Section 8-301, provided that the security certificate has been indorsed to the purchaser or in blank. Section 8-301 provides that delivery of a certificated security occurs when the purchaser obtains possession of the security certificate, or when an agent for the purchaser (other than a securities intermediary) either acquires possession or acknowledges that the agent holds for the purchaser.

3. Subsection (c) specifies the means by which a purchaser can obtain control over uncertificated securities which the transferor holds directly. Two mechanisms are possible.

Under subsection (c)(1), securities can be "delivered" to a purchaser. Section 8-301(b) provides that "delivery" of an uncertificated security occurs when the purchaser becomes the registered holder. So far as the issuer is concerned, the purchaser would then be entitled to exercise all rights of ownership. See Section 8-207. As between the parties to a purchase transaction, however, the rights of the purchaser are determined by their contract. Cf. Section 9-202. Arrangements covered by this paragraph are analogous to arrangements in which bearer certificates are delivered to a secured party — so far as the issuer or any other parties are concerned, the secured party appears to be the outright owner, although it is in fact holding as collateral property that belongs to the debtor.

Under subsection (c)(2), a purchaser has control if the issuer has agreed to act on the instructions of the purchaser, even though the owner remains listed as the registered owner. The issuer, of course, would be acting wrongfully against the registered owner if it entered into such an agreement without the consent of the registered owner. Subsection (g) makes this point explicit. The subsection (c)(2) provision makes it possible for issuers to offer a service akin to the registered pledge device of the 1978 version of Article 8, without mandating that all issuers offer that service.

4. Subsection (d) specifies the means by which a purchaser can obtain control over a security entitlement. Two mechanisms are possible, analogous to those provided in subsection (c) for uncertificated securities. Under subsection (d)(1), a purchaser has control if it is the entitlement holder. This subsection would apply whether the purchaser holds through the same intermediary that the debtor used, or has the securities position transferred to its own intermediary.

Subsection (d)(2) provides that a purchaser has control if the securities intermediary has agreed to act on entitlement orders originated by the purchaser, even though the transferor remains listed as the entitlement holder. This section specifies only the minimum requirements that such an arrangement must meet to confer "control"; the details of the arrangement can be specified by agreement. The arrangement might cover all of the positions in a particular account or subaccount, or only specified positions. There is no requirement that the control party's right to give entitlement orders be exclusive. The arrangement might provide that only the control party can give entitlement orders, or that either the entitlement holder or the control party can give entitlement orders. See subsection (f).

The following examples illustrate the rules of subsection (d):

Example 1. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha Bank also has an account with Able. Debtor instructs Able to transfer the shares to Alpha Bank, and Able does so. Alpha Bank has control of the 1000 shares under subsection (d)(1), because Alpha Bank is the entitlement holder.

Example 2. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha Bank does not have an account with Able. Alpha Bank uses Beta Bank as its securities custodian. Debtor instructs Able to

transfer the shares to Beta Bank, for the account of Alpha Bank, and Able does so. Alpha Bank has control of the 1000 shares under subsection (d)(1), because Alpha Bank is the entitlement holder.

Example 3. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Debtor, Able, and Alpha Bank enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Alpha Bank also has the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 4. Able & Co., a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Alpha Bank's account at Clearing Corporation. Alpha Bank has control of the 1000 shares under subsection (d)(1).

Example 5. Able & Co., a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Alpha Bank does not have an account with Clearing Corporation. It holds its securities through Beta Bank, which does have an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Beta Bank's account at Clearing Corporation. Beta Bank credits the position to Alpha Bank's account with Beta Bank. Alpha Bank has control of the 1000 shares under subsection (d)(1).

Example 6. Able & Co. a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into a pledge account, pursuant to an agreement under which Able will continue to receive dividends, distributions, and the like, but Alpha Bank has the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 7. Able & Co. a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation will act on instructions from Alpha with respect to the XYZ Co. stock carried in Able's account, but Able will continue to receive dividends, distributions, and the like, and will also have the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2).

Example 8. Able & Co. a securities dealer, holds a wide range of securities through its account at Clearing Corporation. Able enters into an arrangement with Alpha Bank pursuant to which Alpha provides financing to Able secured by securities identified as the collateral on lists provided by Able to Alpha on a daily or other periodic basis. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation agrees that if at any time Alpha directs Clearing Corporation to do so, Clearing Corporation will transfer any securities from Able's account at Alpha's instructions. Because Clearing Corporation has agreed to act on Alpha's instructions with respect to any securities carried in Able's account, at the moment that Alpha's security interest attaches to securities listed by Able, Alpha obtains control of those securities under subsection (d)(2). There is no requirement that Clearing Corporation be informed of which securities Able has pledged to Alpha.

5. For a purchaser to have "control" under subsection (c)(2) or (d)(2), it is essential that the issuer or securities intermediary, as the case may be, actually be a party to the agreement. If a debtor gives a secured party a power of attorney authorizing the secured party to act in the name of the debtor, but the issuer or securities intermediary does not specifically agree to this arrangement, the secured party does not have "control" within the meaning of subsection (c)(2) or (d)(2) because the issuer or securities intermediary is not a party to the agreement. The secured party does not have control under subsection (c)(1) or (d)(1) because, although the power of attorney might give the secured party authority to act on the debtor's behalf as an agent, the secured party has not actually become the registered owner or entitlement holder.

6. Subsection (e) provides that if an interest in a security entitlement is granted by an entitlement holder to the securities intermediary through which the security entitlement is maintained, the securities intermediary has control. A common transaction covered by this provision is a margin loan from a broker to its customer.

7. The term "control" is used in a particular defined sense. The requirements for obtaining control are set out in this section. The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting subsection (c)(2) or (d)(2). Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.

The key to the control concept is that the purchaser has the present ability to have the securities sold or transferred without further action by the transferor. There is no requirement that the powers held by the purchaser be exclu-

sive. For example, in a secured lending arrangement, if the secured party wishes, it can allow the debtor to retain the right to make substitutions, or to direct the disposition of the uncertificated security or security entitlement. Subsection (f) is included to make clear the general point stated in subsection (c) that the test of control is whether the purchaser has obtained the requisite power, not whether the debtor has retained other powers. There is no implication that retention by the debtor of powers other than those mentioned in subsection (f) is inconsistent with the purchaser having control.

Definitional Cross References:

"Bearer form". Section 8-102(a)(2)
"Certificated security". Section 8-102(a)(4)
"Delivery". Section 8-301
"Effective". Section 8-107
"Entitlement holder". Section 8-102(a)(7)
"Entitlement order". Section 8-102(a)(8)
"Indorsement". Section 8-102(a)(11)
"Instruction". Section 8-102(a)(12)
"Purchaser". Sections 1-201(33) & 8-116
"Registered form". Section 8-102(a)(13)
"Securities intermediary". Section 8-102(a)(14)
"Security entitlement". Section 8-102(a)(17)
"Uncertificated security". Section 8-102(a)(18)

4-8-107. Whether indorsement, instruction, or entitlement order is effective. (a) "Appropriate person" means:

(1) With respect to an indorsement, the person specified by a security certificate or by an effective special indorsement to be entitled to the security;

(2) With respect to an instruction, the registered owner of an uncertificated security;

(3) With respect to an entitlement order, the entitlement holder;

(4) If the person designated in paragraph (1), (2), or (3) of this subsection (a) is deceased, the designated person's successor taking under other law or the designated person's personal representative acting for the estate of the decedent; or

(5) If the person designated in paragraph (1), (2), or (3) of this subsection (a) lacks capacity, the designated person's guardian, conservator, or other similar representative who has power under other law to transfer the security or financial asset.

(b) An indorsement, instruction, or entitlement order is effective if:

(1) It is made by the appropriate person;

(2) It is made by a person who has power under the law of agency to transfer the security or financial asset on behalf of the appropriate person, including, in the case of an instruction or entitlement order, a person who has control under section 4-8-106 (c) (2) or (d) (2); or

(3) The appropriate person has ratified it or is otherwise precluded from asserting its ineffectiveness.

(c) An indorsement, instruction, or entitlement order made by a representative is effective even if:

(1) The representative has failed to comply with a controlling instrument or with the law of the State having jurisdiction of the representative relationship, including any law requiring the representative to obtain court approval of the transaction; or

(2) The representative's action in making the indorsement, instruction, or entitlement order or using the proceeds of the transaction is otherwise a breach of duty.

(d) If a security is registered in the name of or specially indorsed to a person described as a representative, or if a securities account is maintained in the name of a person described as a representative, an indorsement, instruction, or entitlement order made by the person is effective even though the person is no longer serving in the described capacity.

(e) Effectiveness of an indorsement, instruction, or entitlement order is determined as of the date the indorsement, instruction, or entitlement order is made, and an indorsement, instruction, or entitlement order does not become ineffective by reason of any later change of circumstances.

Source: L. 96: Entire article R&RE, p. 209, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-308 as it existed prior to 1996.

OFFICIAL COMMENT

1. This section defines two concepts, "appropriate person" and "effective." Effectiveness is a broader concept than appropriate person. For example, if a security or securities account is registered in the name of Mary Roe, Mary Roe is the "appropriate person," but an indorsement, instruction, or entitlement order made by John Doe is "effective" if, under agency or other law, Mary Roe is precluded from denying Doe's authority. Treating these two concepts separately facilitates statement of the rules of Article 8 that state the legal effect of an indorsement, instruction, or entitlement order. For example, a securities intermediary is protected against liability if it acts on an effective entitlement order, but has a duty to comply with an entitlement order only if it is originated by an appropriate person. See Sections 8-115 and 8-507.

One important application of the "effectiveness" concept is in the direct holding system rules on the rights of purchasers. A purchaser of a certificated security in registered form can qualify as a protected purchaser who takes free from adverse claims under Section 8-303 only if the purchaser obtains "control." Section 8-106 provides that a purchaser of a certificated security in registered form obtains control if there has been an "effective" indorsement.

2. Subsection (a) provides that the term "appropriate person" covers two categories: (1) the person who is actually designated as the person entitled to the security or security entitlement, and (2) the successor or legal representative of that person if that person has died or otherwise lacks capacity. Other law determines who has power to transfer a security on behalf of a person who lacks capacity. For example, if securities are registered in the name of more than one person and one of the designated persons dies, whether the survivor is the appropriate person depends on the form of tenancy. If the two were registered joint tenants with right of survivorship, the survivor would have that power under other law and thus would be the "appropriate person." If securities are registered in the name of an individual and the individual dies, the law of decedents' estates determines who has power to transfer the decedent's securities. That would ordinarily be the executor or administrator, but if a "small estate statute" permits a widow to transfer a decedent's securities without administration proceedings, she would be the appropriate person. If the registration of a security or a securities account contains a designation of a death beneficiary under the Uniform Transfer on Death Security Registration Act or comparable legislation, the designated beneficiary would, under that law, have power to transfer upon the person's death and so would be the appropriate person. Article 8 does not contain a list of such representatives, because any list is likely to become outdated by developments in other law.

3. Subsection (b) sets out the general rule that an indorsement, instruction, or entitlement order is effective if it is made by the appropriate person or by a person who has power to transfer under agency law or if the appropriate person is precluded from denying its effectiveness. The control rules in Section 8-106 provide for arrangements where a person who holds securities through a securities intermediary, or holds uncertificated securities directly, enters into a control agreement giving the secured party the right to initiate entitlement orders of instructions. Paragraph 2 of subsection (b) states explicitly that an entitlement order or instruction initiated by a person who has obtained such a control agreement is "effective."

Subsections (c), (d), and (e) supplement the general rule of subsection (b) on effectiveness. The term "representative," used in subsections (c) and (d), is defined in Section 1-201(35).

4. Subsection (c) provides that an indorsement, instruction, or entitlement order made by a representative is effective even though the representative's action is a violation of duties. The following example illustrates this subsection:

Example 1. Certificated securities are registered in the name of John Doe. Doe dies and Mary Roe is appointed executor. Roe indorses the security certificate and transfers it to a purchaser in a transaction that is a violation of her duties as executor.

Roe's indorsement is effective, because Roe is the appropriate person under subsection (a)(4). This is so even though Roe's transfer violated her obligations as executor. The policies of free transferability of securities that underlie Article 8 dictate that neither a purchaser to whom Roe transfers the securities nor the issuer who registers transfer should be required to investigate the terms of the will to determine whether Roe is acting properly. Although Roe's indorsement is effective under this section, her breach of duty may be such that her beneficiary has an adverse claim to the securities that Roe transferred. The question whether that adverse claim can be asserted against purchasers is governed not by this section but by Section 8-303. Under Section 8-404, the issuer has no duties to an adverse claimant unless the claimant obtains legal process enjoining the issuer from registering transfer.

5. Subsection (d) deals with cases where a security or a securities account is registered in the name of a person specifically designated as a representative. The following example illustrates this subsection:

Example 2. Certificated securities are registered in the name of "John Jones, trustee of the

Smith Family Trust." John Jones is removed as trustee and Martha Moe is appointed successor trustee. The securities, however, are not reregistered, but remain registered in the name of "John Jones, trustee of the Smith Family Trust." Jones indorses the security certificate and transfers it to a purchaser.

Subsection (d) provides that an indorsement by John Jones as trustee is effective even though Jones is no longer serving in that capacity. Since the securities were registered in the name of "John Jones, trustee of the Smith Family Trust," a purchaser, or the issuer when called upon to register transfer, should be entitled to assume without further inquiry that Jones has the power to act as trustee for the Smith Family Trust.

Note that subsection (d) does not apply to a case where the security or securities account is registered in the name of principal rather than the representative as such. The following example illustrates this point:

Example 3. Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. The securities are not reregistered in the name of Mary Roe as executor. Later, Mary Roe is removed as executor and Martha Moe is appointed as her successor. After being removed, Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser.

Mary Roe's indorsement is not made effective by subsection (d), because the securities were not registered in the name of Mary Roe as representative. A purchaser or the issuer registering transfer should be required to determine whether Roe has power to act for John Doe. Purchasers and issuers can protect themselves in such cases by requiring signature guaranties. See Section 8-306.

6. Subsection (e) provides that the effectiveness of an indorsement, instruction, or entitlement order is determined as of the date it is made. The following example illustrates this subsection:

Example 4. Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser. After the indorsement and transfer, but before the security certificate is presented to the issuer for registration of transfer, Mary Roe is removed as executor and Martha Moe is appointed as her successor.

Mary Roe's indorsement is effective, because at the time Roe indorsed she was the appropriate person under subsection (a)(4). Her later removal as executor does not render the indorsement ineffective. Accordingly, the issuer would not be liable for registering the transfer. See Section 8-404.

Definitional Cross References:

"Entitlement order". Section 8-102(a)(8)
"Financial asset". Section 8-102(a)(9)
"Indorsement". Section 8-102(a)(11)
"Instruction". Section 8-102(a)(12)
"Representative". Section 1-201(35)
"Securities account". Section 8-501
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)
"Security entitlement". Section 8-102(a)(17)
"Uncertificated security". Section 8-102(a)(18)

ANNOTATION

Stock properly indorsed pursuant to subsection (2) where stock pledge agreement specifically authorized lender to sell or transfer stock and retain profits in the event of loan default without need for further authorization. Knappenberger v. Shea, 874 P.2d 498 (Colo. App. 1994) (decided under former § 4-8-308 as it existed prior to the 1996 repeal and reenactment of this article).

4-8-108. Warranties in direct holding. (a) A person who transfers a certificated security to a purchaser for value warrants to the purchaser, and an indorser, if the transfer is by indorsement, warrants to any subsequent purchaser, that:

(1) The certificate is genuine and has not been materially altered;

(2) The transferor or indorser does not know of any fact that might impair the validity of the security;

(3) There is no adverse claim to the security;

(4) The transfer does not violate any restriction on transfer;

(5) If the transfer is by indorsement, the indorsement is made by an appropriate person, or if the indorsement is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(6) The transfer is otherwise effective and rightful.

(b) A person who originates an instruction for registration of transfer of an uncertificated security to a purchaser for value warrants to the purchaser that:

(1) The instruction is made by an appropriate person, or if the instruction is by an agent, the agent has actual authority to act on behalf of the appropriate person;
(2) The security is valid;
(3) There is no adverse claim to the security; and
(4) At the time the instruction is presented to the issuer:
(i) The purchaser will be entitled to the registration of transfer;
(ii) The transfer will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction;
(iii) The transfer will not violate any restriction on transfer; and
(iv) The requested transfer will otherwise be effective and rightful.
(c) A person who transfers an uncertificated security to a purchaser for value and does not originate an instruction in connection with the transfer warrants that:
(1) The uncertificated security is valid;
(2) There is no adverse claim to the security;
(3) The transfer does not violate any restriction on transfer; and
(4) The transfer is otherwise effective and rightful.
(d) A person who indorses a security certificate warrants to the issuer that:
(1) There is no adverse claim to the security; and
(2) The indorsement is effective.
(e) A person who originates an instruction for registration of transfer of an uncertificated security warrants to the issuer that:
(1) The instruction is effective; and
(2) At the time the instruction is presented to the issuer the purchaser will be entitled to the registration of transfer.
(f) A person who presents a certificated security for registration of transfer or for payment or exchange warrants to the issuer that the person is entitled to the registration, payment, or exchange, but a purchaser for value and without notice of adverse claims to whom transfer is registered warrants only that the person has no knowledge of any unauthorized signature in a necessary indorsement.
(g) If a person acts as agent of another in delivering a certificated security to a purchaser, the identity of the principal was known to the person to whom the certificate was delivered, and the certificate delivered by the agent was received by the agent from the principal or received by the agent from another person at the direction of the principal, the person delivering the security certificate warrants only that the delivering person has authority to act for the principal and does not know of any adverse claim to the certificated security.
(h) A secured party who redelivers a security certificate received, or after payment and on order of the debtor delivers the security certificate to another person, makes only the warranties of an agent under subsection (g) of this section.
(i) Except as otherwise provided in subsection (g) of this section, a broker acting for a customer makes to the issuer and a purchaser the warranties provided in subsections (a) through (f) of this section. A broker that delivers a security certificate to its customer, or causes its customer to be registered as the owner of an uncertificated security, makes to the customer the warranties provided in subsection (a) or (b) of this section, and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of the customer.

Source: L. 96: Entire article R&RE, p. 210, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-306 as it existed prior to 1996.

OFFICIAL COMMENT

1. Subsections (a), (b), and (c) deal with warranties by security transferors to purchasers. Subsections (d) and (e) deal with warranties by security transferors to issuers. Subsection (f) deals with presentment warranties.

2. Subsection (a) specifies the warranties

made by a person who transfers a certificated security to a purchaser for value. Paragraphs (3), (4), and (5) make explicit several key points that are implicit in the general warranty of paragraph (6) that the transfer is effective and rightful. Subsection (b) sets forth the warranties made to a purchaser for value by one who originates an instruction. These warranties are quite similar to those made by one transferring a certificated security, subsection (a), the principal difference being the absolute warranty of validity. If upon receipt of the instruction the issuer should dispute the validity of the security, the burden of proving validity is upon the transferor. Subsection (c) provides for the limited circumstances in which an uncertificated security could be transferred without an instruction, see Section 8-301(b)(2). Subsections (d) and (e) give the issuer the benefit of the warranties of an indorser or originator on those matters not within the issuer's knowledge.

3. Subsection (f) limits the warranties made by a purchaser for value without notice whose presentation of a security certificate is defective in some way but to whom the issuer does register transfer. The effect is to deny the issuer a remedy against such a person unless at the time of presentment the person had knowledge of an unauthorized signature in a necessary indorsement. The issuer can protect itself by refusing to make the transfer or, if it registers the transfer before it discovers the defect, by pursuing its remedy against a signature guarantor.

4. Subsection (g) eliminates all substantive warranties in the relatively unusual case of a delivery of certificated security by an agent of a disclosed principal where the agent delivers the exact certificate that it received from or for the principal. Subsection (h) limits the warranties given by a secured party who redelivers a certificate. Subsection (i) specifies the warranties of brokers in the more common scenarios.

5. Under Section 1-102(3) the warranty provisions apply "unless otherwise agreed" and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1)
"Appropriate person". Section 8-107
"Broker". Section 8-102(a)(3)
"Certificated security". Section 8-102(a)(4)
"Indorsement". Section 8-102(a)(11)
"Instruction". Section 8-102(a)(12)
"Issuer". Section 8-201
"Person". Section 1-201(30)
"Purchaser". Sections 1-201(33) & 8-116
"Secured party". Section 9-105(1)(m)
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)
"Uncertificated security". Section 8-102(a)(18)
"Value". Sections 1-201(44) & 8-116

4-8-109. Warranties in indirect holding. (a) A person who originates an entitlement order to a securities intermediary warrants to the securities intermediary that:

(1) The entitlement order is made by an appropriate person, or if the entitlement order is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(2) There is no adverse claim to the security entitlement.

(b) A person who delivers a security certificate to a securities intermediary for credit to a securities account or originates an instruction with respect to an uncertificated security directing that the uncertificated security be credited to a securities account makes to the securities intermediary the warranties specified in section 4-8-108 (a) or (b).

(c) If a securities intermediary delivers a security certificate to its entitlement holder or causes its entitlement holder to be registered as the owner of an uncertificated security, the securities intermediary makes to the entitlement holder the warranties specified in section 4-8-108 (a) or (b).

Source: L. 96: Entire article R&RE, p. 212, § 2, effective July 1.

OFFICIAL COMMENT

1. Subsection (a) provides that a person who originates an entitlement order warrants to the securities intermediary that the order is authorized, and warrants the absence of adverse claims. Subsection (b) specifies the warranties that are given when a person who holds securities directly has the holding converted into indirect form. A person who delivers a certificate to a securities intermediary or originates an instruction for an uncertificated security gives to the securities intermediary the transfer warranties under Section 8-108. If the securities inter-

mediary in turn delivers the certificate to a higher level securities intermediary, it gives the same warranties.

2. Subsection (c) states the warranties that a securities intermediary gives when a customer who has been holding securities in an account with the securities intermediary requests that certificates be delivered or that uncertificated securities be registered in the customer's name. The warranties are the same as those that brokers make with respect to securities that the brokers sell to or buy on behalf of the customers. See Section 8-108(i).

3. As with the Section 8-108 warranties, the warranties specified in this section may be modified by agreement under Section 1-102(3).

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1)
"Appropriate person". Section 8-107
"Entitlement holder". Section 8-102(a)(7)
"Entitlement order". Section 8-102(a)(8)
"Instruction". Section 8-102(a)(12)
"Person". Section 1-201(30)
"Securities account". Section 8-501
"Securities intermediary". Section 8-102(a)(14)
"Security certificate". Section 8-102(a)(16)
"Uncertificated security". Section 8-102(a)(18)

4-8-110. Applicability - choice of law. (a) The local law of the issuer's jurisdiction, as specified in subsection (d) of this section, governs:

(1) The validity of a security;

(2) The rights and duties of the issuer with respect to registration of transfer;

(3) The effectiveness of registration of transfer by the issuer;

(4) Whether the issuer owes any duties to an adverse claimant to a security; and

(5) Whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.

(b) The local law of the securities intermediary's jurisdiction, as specified in subsection (e) of this section, governs:

(1) Acquisition of a security entitlement from the securities intermediary;

(2) The rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;

(3) Whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and

(4) Whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.

(c) The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.

(d) "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized under the law of this state may specify the law of another jurisdiction as the law governing the matters specified in subsection (a) (2) through (a) (5) of this section.

(e) The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:

(1) If an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that a particular jurisdiction is the securities intermediary's jurisdiction for purposes of this part 1, this article, or this title, that jurisdiction is the securities intermediary's jurisdiction.

(2) If paragraph (1) of this subsection (e) does not apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(3) If neither paragraph (1) nor paragraph (2) of this subsection (e) applies and an agreement between the securities intermediary and its entitlement holder expressly provides that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(4) If none of paragraphs (1), (2), or (3) of this subsection (e) applies, the securities intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder's account is located.

(5) If none of paragraphs (1), (2), (3), or (4) of this subsection (e) applies, the securities intermediary's jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is located.

(f) A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other record keeping concerning the account.

Source: L. 96: Entire article R&RE, p. 212, § 2, effective July 1. **L. 2001:** (e) R&RE, p. 1442, § 32, effective July 1.

Editor's note: This section is similar to former § 4-8-106 as it existed prior to 1996.

OFFICIAL COMMENT

1. This section deals with applicability and choice of law issues concerning Article 8. The distinction between the direct and indirect holding systems plays a significant role in determining the governing law. An investor in the direct holding system is registered on the books of the issuer and/or has possession of a security certificate. Accordingly, the jurisdiction of incorporation of the issuer or location of the certificate determine the applicable law. By contrast, an investor in the indirect holding system has a security entitlement, which is a bundle of rights against the securities intermediary with respect to a security, rather than a direct interest in the underlying security. Accordingly, in the rules for the indirect holding system, the jurisdiction of incorporation of the issuer of the underlying security or the location of any certificates that might be held by the intermediary or a higher tier intermediary, do not determine the applicable law.

The phrase "local law" refers to the law of a jurisdiction other than its conflict of laws rules. See Restatement (Second) of Conflict of Laws § 4.

2. Subsection (a) provides that the law of an issuer's jurisdiction governs certain issues where the substantive rules of Article 8 determine the issuer's rights and duties. Paragraph (1) of subsection (a) provides that the law of the issuer's jurisdiction governs the validity of the security. This ensures that a single body of law will govern the questions addressed in Part 2 of Article 8, concerning the circumstances in which an issuer can and cannot assert invalidity as a defense against purchasers. Similarly, paragraphs (2), (3), and (4) of subsection (a) ensure that the issuer will be able to look to a single body of law on the questions addressed in Part 4 of Article 8, concerning the issuer's duties and liabilities with respect to registration of transfer.

Paragraph (5) of subsection (a) applies the law of an issuer's jurisdiction to the question whether an adverse claim can be asserted against a purchaser to whom transfer has been registered, or who has obtained control over an uncertificated security. Although this issue deals with the rights of persons other than the issuer, the law of the issuer's jurisdiction applies because the purchasers to whom the provision applies are those whose protection against adverse claims depends on the fact that their interests have been recorded on the books of the issuer.

The principal policy reflected in the choice of law rules in subsection (a) is that an issuer and others should be able to look to a single body of law on the matters specified in subsection (a), rather than having to look to the law of all of the different jurisdictions in which security holders may reside. The choice of law policies reflected in this subsection do not require that the body of law governing all of the matters specified in subsection (a) be that of the jurisdiction in which the issuer is incorporated. Thus, subsection (d) provides that the term "issuer's jurisdiction" means the jurisdiction in which the issuer is organized, or, if permitted by that law, the law of another jurisdiction selected by the issuer. Subsection (d) also provides that issuers organized under the law of a State which adopts this Article may make such a selection, except as to the validity issue specified in paragraph (1). The question whether an issuer can assert the defense of invalidity may implicate significant policies of the issuer's jurisdiction of incorporation. See, e.g., Section 8-202 and Comments thereto.

Although subsection (a) provides that the issuer's rights and duties concerning registration of transfer are governed by the law of the issuer's jurisdiction, other matters related to registration of transfer, such as appointment of a

guardian for a registered owner or the existence of agency relationships, might be governed by another jurisdiction's law. Neither this section nor Section 1-105 deals with what law governs the appointment of the administrator or executor; that question is determined under generally applicable choice of law rules.

3. Subsection (b) provides that the law of the securities intermediary's jurisdiction governs the issues concerning the indirect holding system that are dealt with in Article 8. Paragraphs (1) and (2) cover the matters dealt with in the Article 8 rules defining the concept of security entitlement and specifying the duties of securities intermediaries. Paragraph (3) provides that the law of the security intermediary's jurisdiction determines whether the intermediary owes any duties to an adverse claimant. Paragraph (4) provides that the law of the security intermediary's jurisdiction determines whether adverse claims can be asserted against entitlement holders and others.

Subsection (e) determines what is a "securities intermediary's jurisdiction." The policy of subsection (b) is to ensure that a securities intermediary and all of its entitlement holders can look to a single, readily-identifiable body of law to determine their rights and duties. Accordingly, subsection (e) sets out a sequential series of tests to facilitate identification of that body of law. Paragraph (1) of subsection (e) permits specification of the governing law by agreement. Because the policy of this section is to enable parties to determine, in advance and with certainty, what law will apply to transactions governed by this Article, the validation of selection of governing law by agreement is not conditioned upon a determination that the jurisdiction whose law is chosen bear a "reasonable relation" to the transaction. See Section 4A-507; compare Section 1-105(1). That is also true with respect to the similar provisions in subsection (d) of this section and in Section 9-103(6).

Subsection (f) makes explicit a point that is implicit in the Article 8 description of a security entitlement as a bundle of rights against the intermediary with respect to a security or other financial asset, rather than as a direct interest in the underlying security or other financial asset. The governing law for relationships in the indirect holding system is not determined by such matters as the jurisdiction of incorporation of the issuer of the securities held through the intermediary, or the location of any physical certificates held by the intermediary or a higher tier intermediary.

4. Subsection (c) provides a choice of law rule for adverse claim issues that may arise in connection with delivery of security certificates in the direct holding system. It applies the law of the place of delivery. If a certificated security issued by an Idaho corporation is sold, and the sale is settled by physical delivery of the certificate from Seller to Buyer in New York, under subsection (c), New York law determines whether Buyer takes free from adverse claims. The domicile of Seller, Buyer, and any adverse claimant is irrelevant.

5. The following examples illustrate how a court in a jurisdiction which has enacted this section would determine the governing law:

Example 1. John Doe, a resident of Kansas, maintains a securities account with Able & Co. Able is incorporated in Delaware. Its chief executive offices are located in Illinois. The office where Doe transacts business with Able is located in Missouri. The agreement between Doe and Able specifies that it is governed by Illinois law. Through the account, Doe holds securities of a Colorado corporation, which Able holds through Clearing Corporation. The rules of Clearing Corporation provide that the rights and duties of Clearing Corporation and its participants are governed by New York law. Subsection (a) specifies that a controversy concerning the rights and duties as between the issuer and Clearing Corporation is governed by Colorado law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between the Clearing Corporation and Able is governed by New York law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

Example 2. Same facts as to Doe and Able as in Example 1. Through the account, Doe holds securities of a Senegalese corporation, which Able holds through Clearing Corporation. Clearing Corporation's operations are located in Belgium, and its rules and agreements with its participants provide that they are governed by Belgian law. Clearing Corporation holds the securities through a custodial account at the Paris branch office of Global Bank, which is organized under English law. The agreement between Clearing Corporation and Global Bank provides that it is governed by French law. Subsection (a) specifies that a controversy concerning the rights and duties as between the issuer and Global Bank is governed by Senegalese law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between Global Bank and Clearing Corporation is governed by French law, that a controversy concerning the rights and duties as between Clearing Corporation and Able is governed by Belgian law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

6. To the extent that this section does not specify the governing law, general choice of law rules apply. For example, suppose that in either of the examples in the preceding Comment, Doe enters into an agreement with Roe, also a resident of Kansas, in which Doe agrees to transfer all of his interests in the securities held through Able to Roe. Article 8 does not deal with

whether such an agreement is enforceable or whether it gives Roe some interest in Doe's security entitlement. This section specifies what jurisdiction's law governs the issues that are dealt with in Article 8. Article 8, however, does specify that securities intermediaries have only limited duties with respect to adverse claims. See Section 8-115. Subsection (b)(3) of this section provides that Illinois law governs whether Able owes any duties to an adverse claimant. Thus, if Illinois has adopted Revised Article 8, Section 8-115 as enacted in Illinois determines whether Roe has any rights against Able.

7. The choice of law provisions concerning security interests in securities and security entitlements are set out in Section 9-103(6).

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1)
"Agreement". Section 1-201(3)
"Certificated security". Section 8-102(a)(4)
"Entitlement holder". Section 8-102(a)(7)
"Financial asset". Section 8-102(a)(9)
"Issuer". Section 8-201
"Person". Section 1-201(30)
"Purchase". Section 1-201(32)
"Securities intermediary". Section 8-102(a)(14)
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)
"Security entitlement". Section 8-102(a)(17)
"Uncertificated security". Section 8-102(a)(18)

ANNOTATION

Law reviews. For article, "Security Transactions and the Conflict of Laws", see 27 Dicta 119 (1950).

Annotator's note. Since § 4-8-110 is similar to § 4-8-106 as it existed prior to the 1996 repeal and reenactment of this article, a relevant case construing that provision has been included in the annotations to this section.

Applied in Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

4-8-111. Clearing corporation rules. A rule adopted by a clearing corporation governing rights and obligations among the clearing corporation and its participants in the clearing corporation is effective even if the rule conflicts with this article and affects another party who does not consent to the rule.

Source: L. 96: Entire article R&RE, p. 214, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-313 as it existed prior to 1996.

OFFICIAL COMMENT

1. The experience of the past few decades shows that securities holding and settlement practices may develop rapidly, and in unforeseeable directions. Accordingly, it is desirable that the rules of Article 8 be adaptable both to ensure that commercial law can conform to changing practices and to ensure that commercial law does not operate as an obstacle to developments in securities practice. Even if practices were unchanging, it would not be possible in a general statute to specify in detail the rules needed to provide certainty in the operations of the clearance and settlement system.

The provisions of this Article and Article 1 on the effect of agreements provide considerable flexibility in the specification of the details of the rights and obligations of participants in the securities holding system by agreement. See Sections 8-504 through 8-509, and Section 1-102(3) and (4). Given the magnitude of the exposures involved in securities transactions, however, it may not be possible for the parties in developing practices to rely solely on private agreements, particularly with respect to matters that might affect others, such as creditors. For example, in order to be fully effective, rules of clearing corporations on the finality or reversibility of securities settlements must not only bind the participants in the clearing corporation but also be effective against their creditors. Section 8-111 provides that clearing corporation rules are effective even if they indirectly affect third parties, such as creditors of a participant. This provision does not, however, permit rules to be adopted that would govern the rights and obligations of third parties other than as a consequence of rules that specify the rights and obligations of the clearing corporation and its participants.

2. The definition of clearing corporation in Section 8-102 covers only federal reserve banks, entities registered as clearing agencies under the federal securities laws, and others subject to comparable regulation. The rules of registered clearing agencies are subject to regulatory oversight under the federal securities laws.

Definitional Cross References:
"Clearing corporation". Section 8-102(a)(5)

4-8-112. Creditor's legal process. (a) The interest of a debtor in a certificated security may be reached by a creditor only by actual seizure of the security certificate by the officer making the attachment or levy, except as otherwise provided in subsection (d) of this section. However, a certificated security for which the certificate has been surrendered to the issuer may be reached by a creditor by legal process upon the issuer.

(b) The interest of a debtor in an uncertificated security may be reached by a creditor only by legal process upon the issuer at its chief executive office in the United States, except as otherwise provided in subsection (d) of this section.

(c) The interest of a debtor in a security entitlement may be reached by a creditor only by legal process upon the securities intermediary with whom the debtor's securities account is maintained, except as otherwise provided in subsection (d) of this section.

(d) The interest of a debtor in a certificated security for which the certificate is in the possession of a secured party, or in an uncertificated security registered in the name of a secured party, or a security entitlement maintained in the name of a secured party, may be reached by a creditor by legal process upon the secured party.

(e) A creditor whose debtor is the owner of a certificated security, uncertificated security, or security entitlement is entitled to aid from a court of competent jurisdiction, by injunction or otherwise, in reaching the certificated security, uncertificated security, or security entitlement or in satisfying the claim by means allowed at law or in equity in regard to property that cannot readily be reached by other legal process.

Source: L. 96: Entire article R&RE, p. 214, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-317 as it existed prior to 1996.

OFFICIAL COMMENT

1. In dealing with certificated securities the instrument itself is the vital thing, and therefore a valid levy cannot be made unless all possibility of the certificate's wrongfully finding its way into a transferee's hands has been removed. This can be accomplished only when the certificate is in the possession of a public officer, the issuer, or an independent third party. A debtor who has been enjoined can still transfer the security in contempt of court. See Overlock v. Jerome-Portland Copper Mining Co., 29 Ariz. 560, 243 P. 400 (1926). Therefore, although injunctive relief is provided in subsection (e) so that creditors may use this method to gain control of the certificated security, the security certificate itself must be reached to constitute a proper levy whenever the debtor has possession.

2. Subsection (b) provides that when the security is uncertificated and registered in the debtor's name, the debtor's interest can be reached only by legal process upon the issuer. The most logical place to serve the issuer would be the place where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is selected as the appropriate place by analogy to Section 9-103(3)(d). See Comment 5(c) to that section. This section indicates only how attachment is to be made, not when it is legally justified. For that reason there is no conflict between this section and Shaffer v. Heitner, 433 U.S. 186 (1977).

3. Subsection (c) provides that a security entitlement can be reached only by legal process upon the debtor's security intermediary. Process is effective only if directed to the debtor's own security intermediary. If Debtor holds securities through Broker, and Broker in turn holds through Clearing Corporation, Debtor's property interest is a security entitlement against Broker. Accordingly, Debtor's creditor cannot reach Debtor's interest by legal process directed to the Clearing Corporation. See also Section 8-115.

4. Subsection (d) provides that when a certificated security, an uncertificated security, or a security entitlement is controlled by a secured party, the debtor's interest can be reached by legal process upon the secured party. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security.

Definitional Cross References:
"Certificated security". Section 8-102(a)(4)
"Issuer". Section 8-201

"Secured party". Section 9-105(1)(m)
"Securities intermediary". Section 8-102(a)(14)
"Security certificate". Section 8-102(a)(16)
"Security entitlement". Section 8-102(a)(17)
"Uncertificated security". Section 8-102(a)(18)

ANNOTATION

I. Attachment or Levy.
II. Aid of Courts.

I. ATTACHMENT OR LEVY.

These cases decided under former provisions which provided for a levy on corporate shares. Conway v. John, 14 Colo. 30, 23 P. 170 (1890); Pullen v. Headberg, 53 Colo. 502, 127 P. 954 (1912); Ellis v. Gibbons, 26 Colo. App. 454, 145 P. 285 (1914); Carlton v. Camfield, 64 Colo. 373, 171 P. 1140 (1918); Snider v. Bourquin, 68 Colo. 207, 188 P. 727 (1920); Hollingsworth v. Multa Trina Ditch Co., 51 F.2d 649 (10th Cir. 1931) (decided under repealed C. L. §§ 5905 through 5910, and laws antecedent thereto).

C.R.C.P. 102, C.R.C.P. 103, and this section may be harmonized so that stock certificates may be reached by a creditor either by actual physical seizure, by a writ of attachment, if actually seized, or by serving the person who possesses the certificate with a writ of garnishment. Moreland v. Alpert, 124 P.3d 896 (Colo. App. 2005).

II. AID OF COURTS.

Section subject to civil rule on injunctions. This section, though adopted as an aid to creditors in reaching corporate stock owned by a debtor and authorizing the courts to aid in securing such assets by injunction or otherwise, is subject to Rule 65, C.R.C.P., there being no special requirements or procedure provided therein by which an injunction or other relief shall be granted. Stull v. District Court, 135 Colo. 86, 308 P.2d 1006 (1957) (decided under repealed § 31-9-13, CRS 53, uniform stock transfer act).

4-8-113. Statute of frauds inapplicable. A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making.

Source: L. 96: Entire article R&RE, p. 215, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-319 as it existed prior to 1996.

OFFICIAL COMMENT

This section provides that the statute of frauds does not apply to contracts for the sale of securities, reversing prior law which had a special statute of frauds in Section 8-319 (1978). With the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business. For securities transactions, whatever benefits a statute of frauds may play in filtering out fraudulent claims are outweighed by the obstacles it places in the development of modern commercial practices in the securities business.

Definitional Cross References:
"Action". Section 1-201(1)
"Contract". Section 1-201(11)
"Writing". Section 1-201(46)

ANNOTATION

Annotator's note. Since § 4-8-113 is similar to § 4-8-319 as it existed prior to the 1996 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

The statute of frauds set out in this section is more limited in its requirements than are more old-fashioned statutes having to do with the sale of goods. Ellis Canning Co. v. Bernstein, 348 F. Supp. 1212 (D. Colo. 1972).

The purpose of this section is to prevent fraud and perjury in the enforcement of obligations depending for their evidence on the unassisted memory of witnesses. Ellis Canning Co.

v. Bernstein, 348 F. Supp. 1212 (D. Colo. 1972).

When parties agree to the tape recording of an oral agreement, such tape recording satisfies the requirements of § 4-8-319. Ellis Canning Co. v. Bernstein, 348 F. Supp. 1212 (D. Colo. 1972).

Where the identity of the contractors is established. With respect to the requirement for signature contained in this section, then, since the clear purpose of this provision is to require identification of the contracting party, where the identity of oral contractors is established a tape recording itself is enough. Ellis Canning Co. v. Bernstein, 348 F. Supp. 1212 (D. Colo. 1972).

The tape recording of an oral contract would be a "reduction to tangible form", under the U.C.C. provisions found in section 4-1-201, defining "written" and "writing". Ellis Canning Co. v. Bernstein, 348 F. Supp. 1212 (D. Colo. 1972).

Where a party admits in his testimony the accuracy of a tape recorded oral contract, then accordingly, he has admitted "in his pleading, testimony, or otherwise in court that a contract was made for sale of a stated quantity of described securities at a defined or stated price". Ellis Canning Co. v. Bernstein, 348 F. Supp. 1212 (D. Colo. 1972).

As to the applicability of the statute of frauds, the retention and enjoyment of the benefits of a bargain validate the alleged unauthorized part of the transaction. Ellis Canning Co. v. Bernstein, 348 F. Supp. 1212 (D. Colo. 1972).

Sufficient part performance is found to take oral agreement out of statute. See Ellis Canning Co. v. Bernstein, 348 F. Supp. 1212 (D. Colo. 1972).

Detrimental reliance on oral promises may compel performance. The principle embodied in section 139 of the restatement (second) of contracts that detrimental action performed in justifiable reliance upon oral promises may be sufficient to compel full or partial performance of the promise in spite of the applicability of a statute of frauds defense that was applicable in a case involving an oral agreement to sell securities. Kiely v. St. Germain, 670 P.2d 764 (Colo. 1983).

4-8-114. Evidentiary rules concerning certificated securities. The following rules apply in an action on a certificated security against the issuer:

(1) Unless specifically denied in the pleadings, each signature on a security certificate or in a necessary indorsement is admitted.

(2) If the effectiveness of a signature is put in issue, the burden of establishing effectiveness is on the party claiming under the signature, but the signature is presumed to be genuine or authorized.

(3) If signatures on a security certificate are admitted or established, production of the certificate entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security.

(4) If it is shown that a defense or defect exists, the plaintiff has the burden of establishing that the plaintiff or some person under whom the plaintiff claims is a person against whom the defense or defect cannot be asserted.

Source: L. 96: Entire article R&RE, p. 215, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-105 as it existed prior to 1996.

OFFICIAL COMMENT

This section adapts the rules of negotiable instruments law concerning procedure in actions on instruments, see Section 3-308, to actions on certificated securities governed by this Article. An "action on a security" includes any action or proceeding brought against the issuer to enforce a right or interest that is part of the security, such as an action to collect principal or interest or a dividend, or to establish a right to vote or to receive a new security under an exchange offer or plan of reorganization. This section applies only to certificated securities; actions on uncertificated securities are governed by general evidentiary principles.

Definitional Cross References:

"Action". Section 1-201(1)
"Burden of establishing". Section 1-201(8)
"Certificated security". Section 8-102(a)(4)
"Indorsement". Section 8-102(a)(11)
"Issuer". Section 8-201
"Presumed". Section 1-201(31)
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)

ANNOTATION

Annotator's note. Since § 4-8-114 is similar to § 4-8-105 as it existed prior to the 1996 repeal and reenactment of this article, a relevant case construing that provision has been included in the annotations to this section.

Applied in Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

4-8-115. Securities intermediary and others not liable to adverse claimant. A securities intermediary that has transferred a financial asset pursuant to an effective entitlement order, or a broker or other agent or bailee that has dealt with a financial asset at the direction of its customer or principal, is not liable to a person having an adverse claim to the financial asset, unless the securities intermediary, or broker or other agent or bailee:

(1) Took the action after it had been served with an injunction, restraining order, or other legal process enjoining it from doing so, issued by a court of competent jurisdiction, and had a reasonable opportunity to act on the injunction, restraining order, or other legal process; or

(2) Acted in collusion with the wrongdoer in violating the rights of the adverse claimant; or

(3) In the case of a security certificate that has been stolen, acted with notice of the adverse claim.

Source: L. 96: Entire article R&RE, p. 215, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-318 as it existed prior to 1996.

OFFICIAL COMMENT

1. Other provisions of Article 8 protect certain purchasers against adverse claims, both for the direct holding system and the indirect holding system. See Sections 8-303 and 8-502. This section deals with the related question of the possible liability of a person who acted as the "conduit" for a securities transaction. It covers both securities intermediaries — the "conduits" in the indirect holding system — and brokers or other agents or bailees — the "conduits" in the direct holding system. The following examples illustrate its operation:

Example 1. John Doe is a customer of the brokerage firm of Able & Co. Doe delivers to Able a certificate for 100 shares of XYZ Co. common stock, registered in Doe's name and properly indorsed, and asks the firm to sell it for him. Able does so. Later, John Doe's spouse Mary Doe brings an action against Able asserting that Able's action was wrongful against her because the XYZ Co. stock was marital property in which she had an interest, and John Doe was acting wrongfully against her in transferring the securities.

Example 2. Mary Roe is a customer of the brokerage firm of Baker & Co. and holds her securities through a securities account with Baker. Roe instructs Baker to sell 100 shares of XYZ Co. common stock that she carried in her account. Baker does so. Later, Mary Roe's spouse John Roe brings an action against Baker asserting that Baker's action was wrongful against him because the XYZ Co. stock was marital property in which he had an interest, and Mary Roe was acting wrongfully against him in transferring the securities.

Under common law conversion principles, Mary Doe might be able to assert that Able & Co. is liable to her in Example 1 for exercising dominion over property inconsistent with her rights in it. On that or some similar theory John Roe might assert that Baker is liable to him in Example 2. Section 8-115 protects both Able and Baker from liability.

2. The policy of this section is similar to that of many other rules of law that protect agents and bailees from liability as innocent converters. If a thief steals property and ships it by mail, express service, or carrier, to another person, the recipient of the property does not obtain good title, even though the recipient may have given value to the thief and had no notice or knowledge that the property was stolen. Accordingly, the true owner can recover the property from the recipient or obtain damages in a conversion or similar action. An action against the postal service, express company, or carrier presents entirely different policy considerations. Accordingly, general tort law protects agents or bailees who act on the instructions of their principals or bailors. See Restatement (Second) of Torts § 235. See also UCC Section 7-404.

3. Except as provided in paragraph 3, this section applies even though the securities inter-

mediary, or the broker or other agent or bailee, had notice or knowledge that another person asserts a claim to the securities. Consider the following examples:

Example 3. Same facts as in Example 1, except that before John Doe brought the XYZ Co. security certificate to Able for sale, Mary Doe telephoned or wrote to the firm asserting that she had an interest in all of John Doe's securities and demanding that they not trade for him.

Example 4. Same facts as in Example 2, except that before Mary Roe gave an entitlement order to Baker to sell the XYZ Co. securities from her account, John Roe telephoned or wrote to the firm asserting that he had an interest in all of Mary Roe's securities and demanding that they not trade for her.

Section 8-115 protects Able and Baker from liability. The protections of Section 8-115 do not depend on the presence or absence of notice of adverse claims. It is essential to the securities settlement system that brokers and securities intermediaries be able to act promptly on the directions of their customers. Even though a firm has notice that someone asserts a claim to a customer's securities or security entitlements, the firm should not be placed in the position of having to make a legal judgment about the validity of the claim at the risk of liability either to its customer or to the third party for guessing wrong. Under this section, the broker or securities intermediary is privileged to act on the instructions of its customer or entitlement holder, unless it has been served with a restraining order or other legal process enjoining it from doing so. This is already the law in many jurisdictions. For example a section of the New York Banking Law provides that banks need not recognize any adverse claim to funds or securities on deposit with them unless they have been served with legal process. N.Y. Banking Law § 134. Other sections of the UCC embody a similar policy. See Sections 3-602, 5-114(2)(b).

Paragraph (1) of this section refers only to a court order enjoining the securities intermediary or the broker or other agent or bailee from acting at the instructions of the customer. It does not apply to cases where the adverse claimant tells the intermediary or broker that the customer has been enjoined, or shows the intermediary or broker a copy of a court order binding the customer.

Paragraph (3) takes a different approach in one limited class of cases, those where a customer sells stolen certificated securities through a securities firm. Here the policies that lead to protection of securities firms against assertions of other sorts of claims must be weighed against the desirability of having securities firms guard against the disposition of stolen securities. Accordingly, paragraph (3) denies protection to a broker, custodian, or other agent or bailee who receives a stolen security certificate from its customer, if the broker, custodian, or other agent or bailee had notice of adverse claims. The circumstances that give notice of adverse claims are specified in Section 8-105. The result is that brokers, custodians, and other agents and bailees face the same liability for selling stolen certificated securities that purchasers face for buying them.

4. As applied to securities intermediaries, this section embodies one of the fundamental principles of the Article 8 indirect holding system rules — that a securities intermediary owes duties only to its own entitlement holders. The following examples illustrate the operation of this section in the multi-tiered indirect holding system:

Example 5. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able acquired the XYZ shares from another firm, Baker & Co., in a transaction that Baker contends was tainted by fraud, giving Baker a right to rescind the transaction and recover the XYZ shares from Able. Baker sends notice to Clearing Corporation stating that Baker has a claim to the 50,000 shares of XYZ Co. in Able's account. Able then initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. Under Section 8-115, Clearing Corporation is privileged to comply with Able's entitlement order, without fear of liability to Baker. This is so even though Clearing Corporation has notice of Baker's claim, unless Baker obtains a court order enjoining Clearing Corporation from acting on Able's entitlement order.

Example 6. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. That trade was made by Able for its own account, and the proceeds were devoted to its own use. Able becomes insolvent, and it is discovered that Able has a shortfall in the shares of XYZ Co. stock that it should have been carrying for its customers. Able's customers bring an action against Clearing Corporation asserting that Clearing Corporation acted wrongfully in transferring the XYZ shares on Able's order because those were shares that should have been held by Able for its customers. Under Section 8-115, Clearing Corporation is not liable to Able's customers, because Clearing Corporation acted on an effective entitlement order of its own entitlement holder, Able. Clearing Corporation's protection against liability does not depend on the presence or absence of notice or knowledge of the claim by Clearing Corporation.

5. If the conduct of a securities intermediary or a broker or other agent or bailee rises to a

level of complicity in the wrongdoing of its customer or principal, the policies that favor protection against liability do not apply. Accordingly, paragraph (2) provides that the protections of this section do not apply if the securities intermediary or broker or other agent or bailee acted in collusion with the customer or principal in violating the rights of another person. The collusion test is intended to adopt a standard akin to the tort rules that determine whether a person is liable as an aider or abettor for the tortious conduct of a third party. See Restatement (Second) of Torts § 876.

Knowledge that the action of the customer is wrongful is a necessary but not sufficient condition of the collusion test. The aspect of the role of securities intermediaries and brokers that Article 8 deals with is the clerical or ministerial role of implementing and recording the securities transactions that their customers conduct. Faithful performance of this role consists of following the instructions of the customer. It is not the role of the record-keeper to police whether the transactions recorded are appropriate, so mere awareness that the customer may be acting wrongfully does not itself constitute collusion. That, of course, does not insulate an intermediary or broker from responsibility in egregious cases where its action goes beyond the ordinary standards of the business of implementing and recording transactions, and reaches a level of affirmative misconduct in assisting the customer in the commission of a wrong.

Definitional Cross References:

"Broker". Section 8-102(a)(3)

"Effective". Section 8-107

"Entitlement order". Section 8-102(a)(8)

"Financial asset". Section 8-102(a)(9)

"Securities intermediary". Section 8-102(a)(14)

"Security certificate". Section 8-102(a)(16)

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Broker's disregard of suspicious circumstances is evidence of bad faith, and constitutes failure to observe commercially reasonable standards. First Nat. Bank v. Gilbert Marshall, 780 P.2d 73 (Colo. App. 1989) (decided under former § 4-8-318 as it existed prior to the 1996 repeal and reenactment of this article).

4-8-116. Securities intermediary as purchaser for value. A securities intermediary that receives a financial asset and establishes a security entitlement to the financial asset in favor of an entitlement holder is a purchaser for value of the financial asset. A securities intermediary that acquires a security entitlement to a financial asset from another securities intermediary acquires the security entitlement for value if the securities intermediary acquiring the security entitlement establishes a security entitlement to the financial asset in favor of an entitlement holder.

Source: L. 96: Entire article R&RE, p. 216, § 2, effective July 1.

OFFICIAL COMMENT

1. This section is intended to make explicit two points that, while implicit in other provisions, are of sufficient importance to the operation of the indirect holding system that they warrant explicit statement. First, it makes clear that a securities intermediary that receives a financial asset and establishes a security entitlement in respect thereof in favor of an entitlement holder is a "purchaser" of the financial asset that the securities intermediary received. Second, it makes clear that by establishing a security entitlement in favor of an entitlement holder a securities intermediary gives value for any corresponding financial asset that the securities intermediary receives or acquires from another party, whether the intermediary holds directly or indirectly.

In many cases a securities intermediary that receives a financial asset will also be transferring value to the person from whom the financial asset was received. That, however, is not always the case. Payment may occur through a different system than settlement of the securities side of the transaction, or the securities might be transferred without a corresponding payment, as when a person moves an account from one securities intermediary to another. Even though the securities intermediary does not give value to the transferor, it does give value by incurring obligations to its own entitlement holder. Although the general definition of value in Section 1-201(44)(d) should be interpreted to cover the point, this section is included to make this point explicit.

2. The following examples illustrate the effect of this section:

Example 1. Buyer buys 1000 shares of XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. In settlement of the trade, the selling broker delivers to Able a security certificate in street name, indorsed in blank, for 1000 shares XYZ Co. stock, which Able holds in its vault. Able credits Buyer's account for securities in that amount. Section 8-116 specifies that Able is a purchaser of the XYZ Co. stock certificate, and gave value for it. Thus, Able can obtain the benefit of Section 8-303, which protects purchasers for value, if it satisfies the other requirements of that section.

Example 2. Buyer buys 1000 shares XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. The trade is settled by crediting 1000 shares XYZ Co. stock to Able's account at Clearing Corporation. Able credits Buyer's account for securities in that amount. When Clearing Corporation credits Able's account, Able acquires a security entitlement under Section 8-501. Section 8-116 specifies that Able acquired this security entitlement for value. Thus, Able can obtain the benefit of Section 8-502, which protects persons who acquire security entitlements for value, if it satisfies the other requirements of that section.

Example 3. Thief steals a certificated bearer bond from Owner. Thief sends the certificate to his broker Able & Co. to be held in his securities account, and Able credits Thief's account for the bond. Section 8-116 specifies that Able is a purchaser of the bond and gave value for it. Thus, Able can obtain the benefit of Section 8-303, which protects purchasers for value, if it satisfies the other requirements of that section.

Definitional Cross References:

"Financial asset". Section 8-102(a)(9)

"Securities intermediary". Section 8-102(a)(14)

"Security entitlement". Section 8-102(a)(17)

"Entitlement holder". Section 8-102(a)(7)

PART 2

ISSUE AND ISSUER

4-8-201. Issuer. (a) With respect to an obligation on or a defense to a security, an "issuer" includes a person that:

(1) Places or authorizes the placing of its name on a security certificate, other than as authenticating trustee, registrar, transfer agent, or the like, to evidence a share, participation, or other interest in its property or in an enterprise, or to evidence its duty to perform an obligation represented by the certificate;

(2) Creates a share, participation, or other interest in its property or in an enterprise, or undertakes an obligation, that is an uncertificated security;

(3) Directly or indirectly creates a fractional interest in its rights or property, if the fractional interest is represented by a security certificate; or

(4) Becomes responsible for, or in place of, another person described as an issuer in this section.

(b) With respect to an obligation on or defense to a security, a guarantor is an issuer to the extent of its guaranty, whether or not its obligation is noted on a security certificate.

(c) With respect to a registration of a transfer, issuer means a person on whose behalf transfer books are maintained.

Source: L. 96: Entire article R&RE, p. 216, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-201 as it existed prior to 1996.

OFFICIAL COMMENT

1. The definition of "issuer" in this section functions primarily to describe the persons whose defenses may be cut off under the rules in Part 2. In large measure it simply tracks the language of the definition of security in Section 8-102(a)(15).

2. Subsection (b) distinguishes the obligations of a guarantor as issuer from those of the principal obligor. However, it does not exempt the guarantor from the impact of subsection (d) of Section 8-202. Whether or not the obligation of the guarantor is noted on the security is immaterial. Typically, guarantors are parent corporations, or stand in some similar relationship to the principal obligor. If that relationship existed at the time the security was originally issued the guaranty would probably have been noted on the security. However, if the relation-

ship arose afterward, e.g., through a purchase of stock or properties, or through merger or consolidation, probably the notation would not have been made. Nonetheless, the holder of the security is entitled to the benefit of the obligation of the guarantor.

3. Subsection (c) narrows the definition of "issuer" for purposes of Part 4 of this Article (registration of transfer). It is supplemented by Section 8-407.

Definitional Cross References:

"Person". Section 1-201(30)
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)
"Uncertificated security". Section 8-102(a)(18)

4-8-202. Issuer's responsibility and defenses - notice of defect or defense. (a) Even against a purchaser for value and without notice, the terms of a certificated security include terms stated on the certificate and terms made part of the security by reference on the certificate to another instrument, indenture, or document or to a constitution, statute, ordinance, rule, regulation, order, or the like, to the extent the terms referred to do not conflict with terms stated on the certificate. A reference under this subsection (a) does not of itself charge a purchaser for value with notice of a defect going to the validity of the security, even if the certificate expressly states that a person accepting it admits notice. The terms of an uncertificated security include those stated in any instrument, indenture, or document or in a constitution, statute, ordinance, rule, regulation, order, or the like, pursuant to which the security is issued.

(b) The following rules apply if an issuer asserts that a security is not valid:

(1) A security other than one issued by a government or governmental subdivision, agency, or instrumentality, even though issued with a defect going to its validity, is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves a violation of a constitutional provision. In that case, the security is valid in the hands of a purchaser for value and without notice of the defect, other than one who takes by original issue.

(2) Paragraph (1) of this subsection (b) applies to an issuer that is a government or governmental subdivision, agency, or instrumentality only if there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(c) Except as otherwise provided in section 4-8-205, lack of genuineness of a certificated security is a complete defense, even against a purchaser for value and without notice.

(d) All other defenses of the issuer of a security, including nondelivery and conditional delivery of a certificated security, are ineffective against a purchaser for value who has taken the certificated security without notice of the particular defense.

(e) This section does not affect the right of a party to cancel a contract for a security "when, as, and if issued" or "when distributed" in the event of a material change in the character of the security that is the subject of the contract or in the plan or arrangement pursuant to which the security is to be issued or distributed.

(f) If a security is held by a securities intermediary against whom an entitlement holder has a security entitlement with respect to the security, the issuer may not assert any defense that the issuer could not assert if the entitlement holder held the security directly.

Source: L. 96: Entire article R&RE, p. 216, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-202 as it existed prior to 1996.

OFFICIAL COMMENT

1. In this Article the rights of the purchaser for value without notice are divided into two aspects, those against the issuer, and those against other claimants to the security. Part 2 of this Article, and especially this section, deal with rights against the issuer.

Subsection (a) states, in accordance with the prevailing case law, the right of the issuer (who prepares the text of the security) to include terms incorporated by adequate reference to an extrinsic source, so long as the terms so incorporated do not conflict with the stated terms.

Thus, the standard practice of referring in a bond or debenture to the trust indenture under which it is issued without spelling out its necessarily complex and lengthy provisions is approved. Every stock certificate refers in some manner to the charter or articles of incorporation of the issuer. At least where there is more than one class of stock authorized applicable corporation codes specifically require a statement or summary as to preferences, voting powers and the like. References to constitutions, statutes, ordinances, rules, regulations or orders are not so common, except in the obligations of governments or governmental agencies or units; but where appropriate they fit into the rule here stated.

Courts have generally held that an issuer is estopped from denying representations made in the text of a security. Delaware-New Jersey Ferry Co. v. Leeds, 21 Del.Ch. 279, 186 A. 913 (1936). Nor is a defect in form or the invalidity of a security normally available to the issuer as a defense. Bonini v. Family Theatre Corporation, 327 Pa. 273, 194 A. 498 (1937); First National Bank of Fairbanks v. Alaska Airmotive, 119 F.2d 267 (C.C.A.Alaska 1941).

2. The rule in subsection (a) requiring that the terms of a security be noted or referred to on the certificate is based on practices and expectations in the direct holding system for certificated securities. This rule does not express a general rule or policy that the terms of a security are effective only if they are communicated to beneficial owners in some particular fashion. Rather, subsection (a) is based on the principle that a purchaser who does obtain a certificate is entitled to assume that the terms of the security have been noted or referred to on the certificate. That policy does not come into play in a securities holding system in which purchasers do not take delivery of certificates.

The provisions of subsection (a) concerning notation of terms on security certificates are necessary only because paper certificates play such an important role for certificated securities that a purchaser should be protected against assertion of any defenses or rights that are not noted on the certificate. No similar problem exists with respect to uncertificated securities. The last sentence of subsection (a) is, strictly speaking, unnecessary, since it only recognizes the fact that the terms of an uncertificated security are determined by whatever other law or agreement governs the security. It is included only to preclude any inference that uncertificated securities are subject to any requirement analogous to the requirement of notation of terms on security certificates.

The rule of subsection (a) applies to the indirect holding system only in the sense that if a certificated security has been delivered to the clearing corporation or other securities intermediary, the terms of the security should be noted or referred to on the certificate. If the security is uncertificated, that principle does not apply even at the issuer-clearing corporation level. The beneficial owners who hold securities through the clearing corporation are bound by the terms of the security, even though they do not actually see the certificate. Since entitlement holders in an indirect holding system have not taken delivery of certificates, the policy of subsection (a) does not apply.

3. The penultimate sentence of subsection (a) and all of subsection (b) embody the concept that it is the duty of the issuer, not of the purchaser, to make sure that the security complies with the law governing its issue. The penultimate sentence of subsection (a) makes clear that the issuer cannot, by incorporating a reference to a statute or other document, charge the purchaser with notice of the security's invalidity. Subsection (b) gives to a purchaser for value without notice of the defect the right to enforce the security against the issuer despite the presence of a defect that otherwise would render the security invalid. There are three circumstances in which a purchaser does not gain such rights: first, if the defect involves a violation of constitutional provisions, these rights accrue only to a subsequent purchaser, that is, one who takes other than by original issue. This Article leaves to the law of each particular State the rights of a purchaser on original issue of a security with a constitutional defect. No negative implication is intended by the explicit grant of rights to a subsequent purchaser.

Second, governmental issuers are distinguished in subsection (b) from other issuers as a matter of public policy, and additional safeguards are imposed before governmental issues are validated. Governmental issuers are estopped from asserting defenses only if there has been substantial compliance with the legal requirements governing the issue or if substantial consideration has been received and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security. The purpose of the substantial compliance requirement is to make certain that a mere technicality as, e.g., in the manner of publishing election notices, shall not be a ground for depriving an innocent purchaser of rights in the security. The policy is here adopted of such cases as Tommie v. City of Gadsden, 229 Ala. 521, 158 So. 763 (1935), in which minor discrepancies in the form of the election ballot used were overlooked and the bonds were declared valid since there had been substantial compliance with the statute.

A long and well established line of federal cases recognizes the principle of estoppel in favor of purchasers for value without notices where municipalities issue bonds containing recitals of compliance with governing constitutional and statutory provisions, made by the

municipal authorities entrusted with determining such compliance. Chaffee County v. Potter, 142 U.S. 355 (1892); Oregon v. Jennings, 119 U.S. 74 (1886); Gunnison County Commissioners v. Rollins, 173 U.S. 255 (1898). This rule has been qualified, however, by requiring that the municipality have power to issue the security. Anthony v. County of Jasper, 101 U.S. 693 (1879); Town of South Ottawa v. Perkins, 94 U.S. 260 (1876). This section follows the case law trend, simplifying the rule by setting up two conditions for an estoppel against a governmental issuer: (1) substantial consideration given, and (2) power in the issuer to borrow money or issue the security for the stated purpose. As a practical matter the problem of policing governmental issuers has been alleviated by the present practice of requiring legal opinions as to the validity of the issue. The bulk of the case law on this point is nearly 100 years old and it may be assumed that the question now seldom arises.

Section 8-210, regarding overissue, provides the third exception to the rule that an innocent purchase for value takes a valid security despite the presence of a defect that would otherwise give rise to invalidity. See that section and its Comment for further explanation.

4. Subsection (e) is included to make clear that this section does not affect the presently recognized right of either party to a "when, as and if" or "when distributed" contract to cancel the contract on substantial change.

5. Subsection (f) has been added because the introduction of the security entitlement concept requires some adaptation of the Part 2 rules, particularly those that distinguish between purchasers who take by original issue and subsequent purchasers. The basic concept of Part 2 is to apply to investment securities the principle of negotiable instruments law that an obligor is precluded from asserting most defenses against purchasers for value without notice. Section 8-202 describes in some detail which defenses issuers can raise against purchasers for value and subsequent purchasers for value. Because these rules were drafted with the direct holding system in mind, some interpretive problems might be presented in applying them to the indirect holding. For example, if a municipality issues a bond in book-entry only form, the only direct "purchaser" of that bond would be the clearing corporation. The policy of precluding the issuer from asserting defenses is, however, equally applicable. Subsection (f) is designed to ensure that the defense preclusion rules developed for the direct holding system will also apply to the indirect holding system.

Definitional Cross References:

"Certificated security". Section 8-102(a)(4)
"Notice". Section 1-201(25)
"Purchaser". Sections 1-201(33) & 8-116
"Security". Section 8-102(a)(15)
"Uncertificated security". Section 8-102(a)(18)
"Value". Sections 1-201(44) & 8-116

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

In order for one to be entitled to the protection afforded by § 4-8-202(2), he must prove that he was a purchaser for value and that either he or his transferor was without notice of the defect in the certificates. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

Stock certificates issued with facsimile signatures of corporate president and secretary are "genuine" under § 4-8-202(3) of the uniform commercial code, though not countersigned by a transfer agent as required. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

"Genuine" means free of forgery or counterfeiting. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

4-8-203. Staleness as notice of defect or defense. After an act or event, other than a call that has been revoked, creating a right to immediate performance of the principal obligation represented by a certificated security or setting a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer, if the act or event:

(1) Requires the payment of money, the delivery of a certificated security, the registration of transfer of an uncertificated security, or any of them on presentation or surrender of the security certificate, the money or security is available on the date set for payment or exchange, and the purchaser takes the security more than one year after that date; or

(2) Is not covered by paragraph (1) of this section and the purchaser takes the security more than two years after the date set for surrender or presentation or the date on which performance became due.

Source: L. 96: Entire article R&RE, p. 217, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-203 as it existed prior to 1996.

OFFICIAL COMMENT

1. The problem of matured or called securities is here dealt with in terms of the effect of such events in giving notice of the issuer's defenses and not in terms of "negotiability". The substance of this section applies only to certificated securities because certificates may be transferred to a purchaser by delivery after the security has matured, been called, or become redeemable or exchangeable. It is contemplated that uncertificated securities which have matured or been called will merely be canceled on the books of the issuer and the proceeds sent to the registered owner. Uncertificated securities which have become redeemable or exchangeable, at the option of the owner, may be transferred to a purchaser, but the transfer is effectuated only by registration of transfer, thus necessitating communication with the issuer. If defects or defenses in such securities exist, the issuer will necessarily have the opportunity to bring them to the attention of the purchaser.

2. The fact that a security certificate is in circulation long after it has been called for redemption or exchange must give rise to the question in a purchaser's mind as to why it has not been surrendered. After the lapse of a reasonable period of time a purchaser can no longer claim "no reason to know" of any defects or irregularities in its issue. Where funds are available for the redemption the security certificate is normally turned in more promptly and a shorter time is set as the "reasonable period" than is set where funds are not available.

Defaulted certificated securities may be traded on financial markets in the same manner as unmatured and undefaulted instruments and a purchaser might not be placed upon notice of irregularity by the mere fact of default. An issuer, however, should at some point be placed in a position to determine definitely its liability on an invalid or improper issue, and for this purpose a security under this section becomes "stale" two years after the default. A different rule applies when the question is notice not of issuer's defenses but of claims of ownership. Section 8-105 and Comment.

3. Nothing in this section is designed to extend the life of preferred stocks called for redemption as "shares of stock" beyond the redemption date. After such a call, the security represents only a right to the funds set aside for redemption.

Definitional Cross References:

"Certificated security". Section 8-102(a)(4)
"Notice". Section 1-201(25)
"Purchaser". Sections 1-201(33) & 8-116
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)
"Uncertificated security". Section 8-102(a)(18)

4-8-204. Effect of issuer's restriction on transfer. A restriction on transfer of a security imposed by the issuer, even if otherwise lawful, is ineffective against a person without knowledge of the restriction unless:

(1) The security is certificated and the restriction is noted conspicuously on the security certificate; or

(2) The security is uncertificated and the registered owner has been notified of the restriction.

Source: L. 96: Entire article R&RE, p. 218, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-204 as it existed prior to 1996.

OFFICIAL COMMENT

1. Restrictions on transfer of securities are imposed by issuers in a variety of circumstances and for a variety of purposes, such as to retain control of a close corporation or to ensure compliance with federal securities laws. Other law determines whether such restrictions are permissible. This section deals only with the consequences of failure to note the restriction on a security certificate.

This section imposes no bar to enforcement of a restriction on transfer against a person who has actual knowledge of it.

2. A restriction on transfer of a certificated security is ineffective against a person without knowledge of the restriction unless the restriction is noted conspicuously on the certificate. The word "noted" is used to make clear that the restriction need not be set forth in full text.

Refusal by an issuer to register a transfer on the basis of an unnoted restriction would be a violation of the issuer's duty to register under Section 8-401.

3. The policy of this section is the same as in Section 8-202. A purchaser who takes delivery of a certificated security is entitled to rely on the terms stated on the certificate. That policy obviously does not apply to uncertificated securities. For uncertificated securities, this section requires only that the registered owner has been notified of the restriction. Suppose, for example, that A is the registered owner of an uncertificated security, and that the issuer has notified A of a restriction on transfer. A agrees to sell the security to B, in violation of the restriction. A completes a written instruction directing the issuer to register transfer to B, and B pays A for the security at the time A delivers the instruction to B. A does not inform B of the restriction, and B does not otherwise have notice or knowledge of it at the time B pays and receives the instruction. B presents the instruction to the issuer, but the issuer refuses to register the transfer on the grounds that it would violate the restriction. The issuer has complied with this section, because it did notify the registered owner A of the restriction. The issuer's refusal to register transfer is not wrongful. B has an action against A for breach of transfer warranty, see Section 8-108(b)(4)(iii). B's mistake was treating an uncertificated security transaction in the fashion appropriate only for a certificated security. The mechanism for transfer of uncertificated securities is registration of transfer on the books of the issuer; handing over an instruction only initiates the process. The purchaser should make arrangements to ensure that the price is not paid until it knows that the issuer has or will register transfer.

4. In the indirect holding system, investors neither take physical delivery of security certificates nor have uncertificated securities registered in their names. So long as the requirements of this section have been satisfied at the level of the relationship between the issuer and the securities intermediary that is a direct holder, this section does not preclude the issuer from enforcing a restriction on transfer. See Section 8-202(a) and Comment 2 thereto.

5. This section deals only with restrictions imposed by the issuer. Restrictions imposed by statute are not affected. See Quiner v. Marblehead Social Co., 10 Mass. 476 (1813); Madison Bank v. Price, 79 Kan. 289, 100 P. 280 (1909); Healey v. Steele Center Creamery Ass'n, 115 Minn. 451, 133 N.W. 69 (1911). Nor does it deal with private agreements between stockholders containing restrictive covenants as to the sale of the security.

Definitional Cross References:

"Certificated security". Section 8-102(a)(4)
"Conspicuous". Section 1-201(10)
"Issuer". Section 8-201
"Knowledge". Section 1-201(25)
"Notify". Section 1-201(25)
"Purchaser". Sections 1-201(33) & 8-116
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)
"Uncertificated security". Section 8-102(a)(18)

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Unless this section is followed, any restriction is void, and a purchaser can compel transfer. Age Publishing Co. v. Becker, 110 Colo. 319, 134 P.2d 205 (1943) (decided under repealed CSA, C. 41, § 100, uniform stock transfer act).

Comments on this section emphasize that it imposes strict requirement for notice on issuer. Edina State Bank v. Mr. Steak, Inc., 487 F.2d 640 (10th Cir. 1973), cert. denied, 419 U.S. 883, 95 S. Ct. 150, 42 L. Ed.2d 123 (1974).

This section represents a change in phraseology, but not in the practical effect. Irwin v. West End Dev. Co., 342 F. Supp. 687 (D. Colo. 1972).

Failure to note the transfer restriction on certificates is no bar to enforcement against one who had actual notice of it. Irwin v. West End Dev. Co., 342 F. Supp. 687 (D. Colo. 1972).

Section does not protect those with actual notice. The purpose of this section was to make ineffective restrictions on transfers to persons without notice. The failure to note the restriction on the certificates is no bar to its enforcement against a person who had actual notice of it. Irwin v. West End Dev. Co., 481 F.2d 34 (10th Cir. 1973), cert. denied, 414 U.S. 1158, 94 S. Ct. 915, 39 L. Ed.2d 110 (1974).

Those on inquiry notice not denied protection of section. This section clearly placed the duty on the issuer to note the restriction conspicuously on the certificate, not on the bank to inquire. And the statute's protection was extended to all against an unnoted restriction except those with "actual knowledge of it". Those who are only on inquiry notice are not denied protection by the code. Edina State Bank v. Mr. Steak, Inc., 487 F.2d 640 (10th Cir. 1973), cert. denied, 419 U.S. 883, 95 S. Ct. 150, 42 L. Ed.2d 123 (1974).

Bank as pledgee was among the persons protected generally by this section against a

restriction not conspicuously noted on the security, except as to a person with actual knowledge. The wrongful refusal to transfer gave rise to a right to sue as for conversion by the bank as transferor. Edina State Bank v. Mr. Steak, Inc., 487 F.2d 640 (10th Cir. 1973), cert. denied, 419 U.S. 883, 95 S. Ct. 150, 42 L. Ed.2d 123 (1974).

Federal securities act does not override section. The absence of a requirement for a notation of the restriction in the federal securities act does not override this section under the doctrine of preemption. This important provision of the code may be read in harmony with the federal statute. Both regulations can be enforced without impairing federal superintendence of the field and thus the state statute need not give way. The securities act shows no intent to prevent such significant regulation by state law. Edina State Bank v. Mr. Steak, Inc., 487 F.2d 640 (10th Cir. 1973), cert. denied, 419 U.S. 883, 95 S. Ct. 150, 42 L. Ed.2d 123 (1974).

Bank's right to damages not defeated by federal statute. The prohibition of the federal statute against carrying out transfers of unregistered stock did not defeat the bank's right to damages under this section. The court did not have to decide whether the bank as a bona fide pledgee could enforce specifically the transfer of the collateral to the purchaser. The only question was whether the bank was entitled to damages when the issuer asserted its own restriction which was not conspicuously noted on its stock certificate as a ground for refusing to register a transfer. In these circumstances the bank was entitled to damages for its loss and the recovery of them was not violative of the federal prohibition against transfer. Edina State Bank v. Mr. Steak, Inc., 487 F.2d 640 (10th Cir. 1973), cert. denied, 419 U.S. 883, 95 S. Ct. 150, 42 L. Ed.2d 123 (1974).

4-8-205. Effect of unauthorized signature on security certificate. An unauthorized signature placed on a security certificate before or in the course of issue is ineffective, but the signature is effective in favor of a purchaser for value of the certificated security if the purchaser is without notice of the lack of authority and the signing has been done by:

(1) An authenticating trustee, registrar, transfer agent, or other person entrusted by the issuer with the signing of the security certificate or of similar security certificates, or the immediate preparation for signing of any of them; or

(2) An employee of the issuer, or of any of the persons listed in paragraph (1) of this section, entrusted with responsible handling of the security certificate.

Source: L. 96: Entire article R&RE, p. 218, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-205 as it existed prior to 1996.

OFFICIAL COMMENT

1. The problem of forged or unauthorized signatures may arise where an employee of the issuer, transfer agent, or registrar has access to securities which the employee is required to prepare for issue by affixing the corporate seal or by adding a signature necessary for issue. This section is based upon the issuer's duty to avoid the negligent entrusting of securities to such persons. Issuers have long been held responsible for signatures placed upon securities by parties whom they have held out to the public as authorized to prepare such securities. See Fifth Avenue Bank of New York v. The Forty-Second & Grand Street Ferry Railroad Co., 137 N.Y. 231, 33 N.E. 378, 19 L.R.A. 331, 33 Am.St.Rep. 712 (1893); Jarvis v. Manhattan Beach Co., 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). The "apparent authority" concept of some of the case-law, however, is here extended and this section expressly rejects the technical distinction, made by courts reluctant to recognize forged signatures, between cases where forgers sign signatures they are authorized to sign under proper circumstances and those in which they sign signatures they are never authorized to sign. Citizens' & Southern National Bank v. Trust Co. of Georgia, 50 Ga.App. 681, 179 S.E. 278 (1935). Normally the purchaser is not in a position to determine which signature a forger, entrusted with the preparation of securities, has "apparent authority" to sign. The issuer, on the other hand, can protect itself against such fraud by the careful selection and bonding of agents and employees, or by action over against transfer agents and registrars who in turn may bond their personnel.

2. The issuer cannot be held liable for the honesty of employees not entrusted, directly or indirectly, with the signing, preparation, or responsible handling of similar securities and whose possible commission of forgery it has no reason to anticipate. The result in such cases as Hudson Trust Co. v. American Linseed Co., 232 N.Y. 350, 134 N.E. 178 (1922), and Dollar Savings Fund & Trust Co. v. Pittsburgh Plate Glass Co., 213 Pa. 307, 62 A. 916, 5 Ann.Cas. 248 (1906) is here adopted.

3. This section is not concerned with forged or unauthorized indorsements, but only with unauthorized signatures of issuers, transfer agents, etc., placed upon security certificates during the course of their issue. The protection here stated is available to all purchasers for value without notice and not merely to subsequent purchasers.

Definitional Cross References:
"Certificated security". Section 8-102(a)(4)
"Issuer". Section 8-201
"Notice". Section 1-201(25)
"Purchaser". Sections 1-201(33) & 8-116
"Security certificate". Section 8-102(a)(14)
"Unauthorized signature". Section 1-201(43)

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Where transferees are purchasers for value without notice of lack of authority, and the signing is done by the secretary of the issuer who is an employee entrusted with responsible handling of securities, it is readily apparent that facsimile signatures are effective against the issuer, and therefore, the certificates are genuine even though the signatures of the president and secretary of the issuer are unauthorized. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

4-8-206. Completion or alteration of security certificate. (a) If a security certificate contains the signatures necessary to its issue or transfer but is incomplete in any other respect:

(1) Any person may complete it by filling in the blanks as authorized; and

(2) Even if the blanks are incorrectly filled in, the security certificate as completed is enforceable by a purchaser who took it for value and without notice of the incorrectness.

(b) A complete security certificate that has been improperly altered, even if fraudulently, remains enforceable, but only according to its original terms.

Source: L. 96: Entire article R&RE, p. 218, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-206 as it existed prior to 1996.

OFFICIAL COMMENT

1. The problem of forged or unauthorized signatures necessary for the issue or transfer of a security is not involved here, and a person in possession of a blank certificate is not, by this section, given authority to fill in blanks with such signatures. Completion of blanks left in a transfer instruction is dealt with elsewhere (Section 8-305(a)).

2. Blanks left upon issue of a security certificate are the only ones dealt with here, and a purchaser for value without notice is protected. A purchaser is not in a good position to determine whether blanks were completed by the issuer or by some person not authorized to complete them. On the other hand the issuer can protect itself by not placing its signature on the writing until the blanks are completed or, if it does sign before all blanks are completed, by carefully selecting the agents and employees to whom it entrusts the writing after authentication. With respect to a security certificate that is completed by the issuer but later is altered, the issuer has done everything it can to protect the purchaser and thus is not charged with the terms as altered. However, it is charged according to the original terms, since it is not thereby prejudiced. If the completion or alteration is obviously irregular, the purchaser may not qualify as a purchaser who took without notice under this section.

3. Only the purchaser who physically takes the certificate is directly protected. However, a transferee may receive protection indirectly through Section 8-302(a).

4. The protection granted a purchaser for value without notice under this section is modified to the extent that an overissue may result where an incorrect amount is inserted into a blank (Section 8-210).

Definitional Cross References:
"Notice". Section 1-201(25)
"Purchaser". Sections 1-201(33) & 8-116
"Security certificate". Section 8-102(a)(16)
"Unauthorized signature". Section 1-201(43)
"Value". Sections 1-201(44) & 8-116

4-8-207. Rights and duties of issuer with respect to registered owners. (a) Before due presentment for registration of transfer of a certificated security in registered form or

of an instruction requesting registration of transfer of an uncertificated security, the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner.

(b) This article does not affect the liability of the registered owner of a security for a call, assessment, or the like.

Source: L. 96: Entire article R&RE, p. 219, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-207 as it existed prior to 1996.

OFFICIAL COMMENT

1. Subsection (a) states the issuer's right to treat the registered owner of a security as the person entitled to exercise all the rights of an owner. This right of the issuer is limited by the provisions of Part 4 of this article. Once there has been due presentation for registration of transfer, the issuer has a duty to register ownership in the name of the transferee. Section 8-401. Thus its right to treat the old registered owner as exclusively entitled to the rights of ownership must cease.

The issuer may under this section make distributions of money or securities to the registered owners of securities without requiring further proof of ownership, provided that such distributions are distributable to the owners of all securities of the same issue and the terms of the security do not require surrender of a security certificate as a condition of payment or exchange. Any such distribution shall constitute a defense against a claim for the same distribution by a person, even if that person is in possession of the security certificate and is a protected purchaser of the security. See PEB Commentary No. 4, dated March 10, 1990.

2. Subsection (a) is permissive and does not require that the issuer deal exclusively with the registered owner. It is free to require proof of ownership before paying out dividends or the like if it chooses to. Barbato v. Breeze Corporation, 128 N.J.L. 309, 26 A.2d 53 (1942).

3. This section does not operate to determine who is finally entitled to exercise voting and other rights or to receive payments and distributions. The parties are still free to incorporate their own arrangements as to these matters in seller-purchaser agreements which may be definitive as between them.

4. No change in existing state laws as to the liability of registered owners for calls and assessments is here intended; nor is anything in this section designed to estop record holders from denying ownership when assessments are levied if they are otherwise entitled to do so under state law. See State ex rel. Squire v. Murfey, Blosson & Co., 131 Ohio St. 289, 2 N.E.2d 866 (1936); Willing v. Delaplaine, 23 F.Supp. 579 (1937).

5. No interference is intended with the common practice of closing the transfer books or taking a record date for dividend, voting, and other purposes, as provided for in by-laws, charters, and statutes.

Definitional Cross References:

"Certificated security". Section 8-102(a)(4)
"Instruction". Section 8-102(a)(12)
"Issuer". Section 8-201
"Registered form". Section 8-102(a)(13)
"Security". Section 8-102(a)(15)
"Uncertificated security". Section 8-102(a)(18)

ANNOTATION

Law reviews. For article, "One Year Review of Corporations, Partnerships, and Agency", see 34 Dicta 129 (1957).

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Under this section, unless otherwise provided, every shareholder of record of a corporation shall have the right at every shareholders' meeting to vote one vote for every share standing in his name on the books of the corporation, even though at some time in the future he intends to dispose of his stock. Fehr v. Hadden, 134 Colo. 102, 300 P.2d 533 (1956).

The argument that equitable owners are entitled to vote is without merit, inasmuch as "title" to corporate stock means "legal title" and does not include a merely equitable or beneficial ownership or interest. Fehr v. Hadden, 134 Colo. 102, 300 P.2d 533 (1956).

4-8-208. Effect of signature of authenticating trustee, registrar, or transfer agent. (a) A person signing a security certificate as authenticating trustee, registrar, transfer agent, or the like, warrants to a purchaser for value of the certificated security, if the purchaser is without notice of a particular defect, that:

(1) The certificate is genuine;

(2) The person's own participation in the issue of the security is within the person's capacity and within the scope of the authority received by the person from the issuer; and

(3) The person has reasonable grounds to believe that the certificated security is in the form and within the amount the issuer is authorized to issue.

(b) Unless otherwise agreed, a person signing under subsection (a) of this section does not assume responsibility for the validity of the security in other respects.

Source: L. 96: Entire article R&RE, p. 219, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-208 as it existed prior to 1996.

OFFICIAL COMMENT

1. The warranties here stated express the current understanding and prevailing case law as to the effect of the signatures of authenticating trustees, transfer agents, and registrars. See Jarvis v. Manhattan Beach Co., 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). Although it has generally been regarded as the particular obligation of the transfer agent to determine whether securities are in proper form as provided by the by-laws and Articles of Incorporation, neither a registrar nor an authenticating trustee should properly place a signature upon a certificate without determining whether it is at least regular on its face. The obligations of these parties in this respect have therefore been made explicit in terms of due care. See Feldmeier v. Mortgage Securities, Inc., 34 Cal.App.2d 201, 93 P.2d 593 (1939).

2. Those cases which hold that an authenticating trustee is not liable for any defect in the mortgage or property which secures the bond or for any fraudulent misrepresentations made by the issuer are not here affected since these matters do not involve the genuineness or proper form of the security. Ainsa v. Mercantile Trust Co., 174 Cal. 504, 163 P. 898 (1917); Tschetinian v. City Trust Co., 186 N.Y. 432, 79 N.E. 401 (1906); Davidge v. Guardian Trust Co. of New York, 203 N.Y. 331, 96 N.E. 751 (1911).

3. The charter or an applicable statute may affect the capacity of a bank or other corporation undertaking to act as an authenticating trustee, registrar, or transfer agent. See, for example, the Federal Reserve Act (U.S.C.A., Title 12, Banks and Banking, Section 248) under which the Board of Governors of the Federal Reserve Bank is authorized to grant special permits to National Banks permitting them to act as trustees. Such corporations are therefore held to certify as to their legal capacity to act as well as to their authority.

4. Authenticating trustees, registrars, and transfer agents have normally been held liable for an issue in excess of the authorized amount. Jarvis v. Manhattan Beach Co., supra; Mullen v. Eastern Trust & Banking Co., 108 Me. 498, 81 A. 948 (1911). In imposing upon these parties a duty of due care with respect to the amount they are authorized to help issue, this section does not necessarily validate the security, but merely holds persons responsible for the excess issue liable in damages for any loss suffered by the purchaser.

5. Aside from questions of genuineness and excess issue, these parties are not held to certify as to the validity of the security unless they specifically undertake to do so. The case law which has recognized a unique responsibility on the transfer agent's part to testify as to the validity of any security which it countersigns is rejected.

6. This provision does not prevent a transfer agent or issuer from agreeing with a registrar of stock to protect the registrar in respect of the genuineness and proper form of a security certificate signed by the issuer or the transfer agent or both. Nor does it interfere with proper indemnity arrangements between the issuer and trustees, transfer agents, registrars, and the like.

7. An unauthorized signature is a signature for purposes of this section if and only if it is made effective by Section 8-205.

Definitional Cross References:

"Certificated security". Section 8-102(a)(4)
"Genuine". Section 1-201(18)
"Issuer". Section 8-201
"Notice". Section 1-201(25)
"Purchaser". Sections 1-201(33) & 8-116
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)
"Uncertificated security". Section 8-102(a)(18)
"Value". Sections 1-201(44) & 8-116

4-8-209. Issuer's lien. A lien in favor of an issuer upon a certificated security is valid against a purchaser only if the right of the issuer to the lien is noted conspicuously on the security certificate.

Source: L. 96: Entire article R&RE, p. 219, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-103 as it existed prior to 1996.

OFFICIAL COMMENT

This section is similar to Sections 8-202 and 8-204 which require that the terms of a certificated security and any restriction on transfer imposed by the issuer be noted on the security certificate. This section differs from those two sections in that the purchaser's knowledge of the issuer's claim is irrelevant. "Noted" makes clear that the text of the lien provisions need not be set forth in full. However, this would not override a provision of an applicable corporation code requiring statement in haec verba. This section does not apply to uncertificated securities. It applies to the indirect holding system in the same fashion as Sections 8-202 and 8-204, see Comment 2 to Section 8-202.

Definitional Cross References:

"Certificated security". Section 8-102(a)(4)
"Issuer". Section 8-201
"Purchaser". Sections 1-201(33) & 8-116
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)

ANNOTATION

Law reviews. For article, "The Pledgee's Right to Stock Dividends Without Shareholder's Liability", see 7 Rocky Mt. L. Rev. 13 (1934). For note, "Stock Liens and Transfer Restrictions Under the Uniform Stock Transfer Act", see 10 Rocky Mt. L. Rev. 117 (1938).

4-8-210. Overissue. (a) In this section, "overissue" means the issue of securities in excess of the amount the issuer has corporate power to issue, but an overissue does not occur if appropriate action has cured the overissue.

(b) Except as otherwise provided in subsections (c) and (d) of this section, the provisions of this article which validate a security or compel its issue or reissue do not apply to the extent that validation, issue, or reissue would result in overissue.

(c) If an identical security not constituting an overissue is reasonably available for purchase, a person entitled to issue or validation may compel the issuer to purchase the security and deliver it if certificated or register its transfer if uncertificated, against surrender of any security certificate the person holds.

(d) If a security is not reasonably available for purchase, a person entitled to issue or validation may recover from the issuer the price the person or the last purchaser for value paid for it with interest from the date of the person's demand.

Source: L. 96: Entire article R&RE, p. 219, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-104 as it existed prior to 1996.

OFFICIAL COMMENT

1. Deeply embedded in corporation law is the conception that "corporate power" to issue securities stems from the statute, either general or special, under which the corporation is organized. Corporation codes universally require that the charter or articles of incorporation state, at least as to capital shares, maximum limits in terms of number of shares or total dollar capital. Historically, special incorporation statutes are similarly drawn and sometimes similarly limit the face amount of authorized debt securities. The theory is that issue of securities in excess of the authorized amounts is prohibited. See, for example, McWilliams v. Geddes & Moss Undertaking Co., 169 So. 894 (1936, La.); Crawford v. Twin City Oil Co., 216 Ala. 216, 113 So. 61 (1927); New York and New Haven R.R. Co. v. Schuyler, 34 N.Y. 30 (1865). This conception persists despite modern corporation codes under which, by action of directors and stockholders, additional shares can be authorized by charter amendment and thereafter issued. This section does not give a person entitled to validation, issue, or reissue of a security, the right to compel amendment of the charter to authorize additional shares. Therefore, in a case where issue of an additional security would require charter amendment, the plaintiff is limited to the two alternate remedies set forth in subsections (c) and (d). The last clause of subsection (a), which

is added in Revised Article 8, does, however, recognize that under modern conditions, overissue may be a relatively minor technical problem that can be cured by appropriate action under governing corporate law.

2. Where an identical security is reasonably available for purchase, whether because traded on an organized market, or because one or more security owners may be willing to sell at a not unreasonable price, the issuer, although unable to issue additional shares, will be able to purchase them and may be compelled to follow that procedure. West v. Tintic Standard Mining Co., 71 Utah 158, 263 P. 490 (1928).

3. The right to recover damages from an issuer who has permitted an overissue to occur is well settled. New York and New Haven R.R. Co. v. Schuyler, 34 N.Y. 30 (1865). The measure of such damages, however, has been open to question, some courts basing them upon the value of stock at the time registration is refused; some upon the value at the time of trial; and some upon the highest value between the time of refusal and the time of trial. Allen v. South Boston Railroad, 150 Mass. 200, 22 N.E. 917, 5 L.R.A. 716, 15 Am.St.Rep. 185 (1889); Commercial Bank v. Kortright, 22 Wend. (N.Y.) 348 (1839). The purchase price of the security to the last purchaser who gave value for it is here adopted as being the fairest means of reducing the possibility of speculation by the purchaser. Interest may be recovered as the best available measure of compensation for delay.

Definitional Cross References:

"Issuer". Section 8-201

"Security". Section 8-102(a)(15)

"Security certificate". Section 8-102(a)(16)

"Uncertificated security". Section 8-102(a)(18)

PART 3

TRANSFER OF CERTIFICATED AND UNCERTIFICATED SECURITIES

4-8-301. Delivery. (a) Delivery of a certificated security to a purchaser occurs when:

(1) The purchaser acquires possession of the security certificate;

(2) Another person, other than a securities intermediary, either acquires possession of the security certificate on behalf of the purchaser or, having previously acquired possession of the certificate, acknowledges that it holds for the purchaser; or

(3) A securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and is (i) registered in the name of the purchaser, (ii) payable to the order of the purchaser, or (iii) specially indorsed to the purchaser by an effective indorsement and has not been indorsed to the securities intermediary or in blank.

(b) Delivery of an uncertificated security to a purchaser occurs when:

(1) The issuer registers the purchaser as the registered owner, upon original issue or registration of transfer; or

(2) Another person, other than a securities intermediary, either becomes the registered owner of the uncertificated security on behalf of the purchaser or, having previously become the registered owner, acknowledges that it holds for the purchaser.

Source: L. 96: Entire article R&RE, p. 220, § 2, effective July 1. **L. 2001:** (a)(3) amended, p. 1443, § 33, effective July 1.

Editor's note: This section is similar to former §§ 4-8-311 and 4-8-313 as they existed prior to 1996.

OFFICIAL COMMENT

1. This section specifies the requirements for "delivery" of securities. Delivery is used in Article 8 to describe the formal steps necessary for a purchaser to acquire a direct interest in a security under this Article. The concept of delivery refers to the implementation of a transaction, not the legal categorization of the transaction which is consummated by delivery. Issuance and transfer are different kinds of transaction, though both may be implemented by delivery. Sale and pledge are different kinds of transfers, but both may be implemented by delivery.

2. Subsection (a) defines delivery with respect to certificated securities. Paragraph (1) deals with simple cases where purchasers themselves acquire physical possession of certificates. Paragraphs (2) and (3) of subsection (a)

specify the circumstances in which delivery to a purchaser can occur although the certificate is in the possession of a person other than the purchaser. Paragraph (2) contains the general rule that a purchaser can take delivery through another person, so long as the other person is actually acting on behalf of the purchaser or acknowledges that it is holding on behalf of the purchaser. Paragraph (2) does not apply to acquisition of possession by a securities intermediary, because a person who holds securities through a securities account acquires a security entitlement, rather than having a direct interest. See Section 8-501. Subsection (a)(3) specifies the limited circumstances in which delivery of security certificates to a securities intermediary is treated as a delivery to the customer.

3. Subsection (b) defines delivery with respect to uncertificated securities. Use of the term "delivery" with respect to uncertificated securities, does, at least on first hearing, seem a bit solecistic. The word "delivery" is, however, routinely used in the securities business in a broader sense than manual tradition. For example, settlement by entries on the books of a clearing corporation is commonly called "delivery," as in the expression "delivery versus payment." The diction of this section has the advantage of using the same term for uncertificated securities as for certificated securities, for which delivery is conventional usage. Paragraph (1) of subsection (b) provides that delivery occurs when the purchaser becomes the registered owner of an uncertificated security, either upon original issue or registration of transfer. Paragraph (2) provides for delivery of an uncertificated security through a third person, in a fashion analogous to subsection (a)(2).

Definitional Cross References:

"Certificated security". Section 8-102(a)(4)
"Effective". Section 8-107
"Issuer". Section 8-201
"Purchaser". Sections 1-201(33) & 8-116
"Registered form". Section 8-102(a)(13)
"Securities intermediary". Section 8-102(a)(14)
"Security certificate". Section 8-102(a)(16)
"Special indorsement". Section 8-304(a)
"Uncertificated security". Section 8-102(a)(18)

4-8-302. Rights of purchaser. (a) Except as otherwise provided in subsections (b) and (c) of this section, a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer.

(b) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

(c) A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve its position by taking from a protected purchaser.

Source: L. 96: Entire article R&RE, p. 220, § 2, effective July 1. **L. 2001:** (a) amended, p. 1443, § 34, effective July 1.

Editor's note: This section is similar to former §§ 4-8-301 and 4-8-302 as they existed prior to 1996.

OFFICIAL COMMENT

1. Subsection (a) provides that if a certificated or uncertificated security is delivered (Section 8-301) to a purchaser in a transfer, the purchaser acquires all rights that the transferor had or had power to transfer. This statement of the familiar "shelter" principle is qualified by the exceptions that a purchaser of a limited interest acquires only that interest, subsection (b), and that a person who does not qualify as a protected purchaser cannot improve its position by taking from a subsequent protected purchaser, subsection (c).

2. Although this section provides that a purchaser acquires a property interest in a certificated or uncertificated security upon "delivery," it does not state that a person can acquire an interest in a security only by delivery. Article 8 is not a comprehensive codification of all of the law governing the creation or transfer of interests in securities. For example, the grant of a security interest is a transfer of a property interest, but the formal steps necessary to effectuate such a transfer are governed by Article 9 not by Article 8. Under the Article 9 rules, a security interest in a certificated or uncertificated security can be created by execution of a security agreement under Section 9-203 and can be perfected by filing. A transfer of an Article 9 security interest can be implemented by an Article 8 delivery, but need not be.

Similarly, Article 8 does not determine whether a property interest in certificated or uncertificated security is acquired under other law, such as the law of gifts, trusts, or equitable remedies. Nor does Article 8 deal with transfers by operation of law. For example, transfers from decedent to administrator, from ward to guardian, and from bankrupt to trustee in bankruptcy

are governed by other law as to both the time they occur and the substance of the transfer. The Article 8 rules do, however, determine whether the issuer is obligated to recognize the rights that a third party, such as a transferee, may acquire under other law. See Sections 8-207, 8-401, and 8-404.

Definitional Cross References:

"Certificated security". Section 8-102(a)(4)

"Notice of adverse claim". Section 8-105

"Protected purchaser". Section 8-303

"Purchaser". Sections 1-201(33) & 8-116

"Uncertificated security". Section 8-102(a)(18)

"Delivery". Section 8-301

ANNOTATION

Law reviews. For article, "One Year Review of Corporations, Partnerships, and Agency", see 34 Dicta 129 (1957).

Annotator's note. Since § 4-8-302 is similar to § 4-8-301 as it existed prior to the 1996 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Under this section, one acquires the rights in a security which his transferor had. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

In order for one to be entitled to the protection afforded by this section, he must prove that he was a purchaser for value, and that either he or his transferor was without notice of a defect in the certificates. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

If one's transferor was without notice of a defect in the certificates, then the defect is ineffective against the transferor by virtue of § 8-4-202(2)(a), and he has the right to require the transfer of the certificates; therefore, when such an individual purchases the certificates from his transferor he acquires his transferor's right to require the issuer to transfer the certificates. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

Purchaser of limited tax bond was not a "protected purchaser" acquiring rights greater than the seller held because purchaser had prior notice of another's adverse claim. Meadow Homes Dev. Corp. v. Bowens, 211 P.3d 743 (Colo. App. 2009).

For the construction of "title" under prior provisions, see Fehr v. Hadden, 134 Colo. 102, 300 P.2d 533 (1956); Arfsten v. Higby, 150 Colo. 254, 372 P.2d 166 (1962) (decided under repealed § 31-9-21, CRS 53, uniform stock transfer act).

4-8-303. Protected purchaser. (a) "Protected purchaser" means a purchaser of a certificated or uncertificated security, or of an interest therein, who:

(1) Gives value;

(2) Does not have notice of any adverse claim to the security; and

(3) Obtains control of the certificated or uncertificated security.

(b) In addition to acquiring the rights of a purchaser, a protected purchaser also acquires its interest in the security free of any adverse claim.

Source: L. 96: Entire article R&RE, p. 221, § 2, effective July 1.

Editor's note: This section is similar to former §§ 4-8-302 and 4-8-311 as they existed prior to 1996.

OFFICIAL COMMENT

1. Subsection (a) lists the requirements that a purchaser must meet to qualify as a "protected purchaser." Subsection (b) provides that a protected purchaser takes its interest free from adverse claims. "Purchaser" is defined broadly in Section 1-201. A secured party as well as an outright buyer can qualify as a protected purchaser. Also, "purchase" includes taking by issue, so a person to whom a security is originally issued can qualify as a protected purchaser.

2. To qualify as a protected purchaser, a purchaser must give value, take without notice of any adverse claim, and obtain control. Value is used in the broad sense defined in Section 1-201(44). See also Section 8-116 (securities intermediary as purchaser for value). Adverse claim is defined in Section 8-102(a)(1). Section 8-105 specifies whether a purchaser has notice of an adverse claim. Control is defined in Section 8-106. To qualify as a protected purchaser there must be a time at which all of the requirements are satisfied. Thus if a purchaser obtains notice of an adverse claim before giving value or satisfying the requirements for control, the

purchaser cannot be a protected purchaser. See also Section 8-304(d).

The requirement that a protected purchaser obtain control expresses the point that to qualify for the adverse claim cut-off rule a purchaser must take through a transaction that is implemented by the appropriate mechanism. By contrast, the rules in Part 2 provide that any purchaser for value of a security without notice of a defense may take free of the issuer's defense based on that defense. See Section 8-202.

3. The requirements for control differ depending on the form of the security. For securities represented by bearer certificates, a purchaser obtains control by delivery. See Sections 8-106(a) and 8-301(a). For securities represented by certificates in registered form, the requirements for control are: (1) delivery as defined in Section 8-301(b), plus (2) either an effective indorsement or registration of transfer by the issuer. See Section 8-106(b). Thus, a person who takes through a forged indorsement does not qualify as a protected purchaser by virtue of the delivery alone. If, however, the purchaser presents the certificate to the issuer for registration of transfer, and the issuer registers transfer over the forged indorsement, the purchaser can qualify as a protected purchaser of the new certificate. If the issuer registers transfer on a forged indorsement, the true owner will be able to recover from the issuer for wrongful registration, see Section 8-404, unless the owner's delay in notifying the issuer of a loss or theft of the certificate results in preclusion under Section 8-406.

For uncertificated securities, a purchaser can obtain control either by delivery, see Sections 8-106(c)(1) and 8-301(b), or by obtaining an agreement pursuant to which the issuer agrees to act on instructions from the purchaser without further consent from the registered owner, see Section 8-106(c)(2). The control agreement device of Section 8-106(c)(2) takes the place of the "registered pledge" concept of the 1978 version of Article 8. A secured lender who obtains a control agreement under Section 8-106(c)(2) can qualify as a protected purchaser of an uncertificated security.

4. This section states directly the rules determining whether one takes free from adverse claims without using the phrase "good faith." Whether a person who takes under suspicious circumstances is disqualified is determined by the rules of Section 8-105 on notice of adverse claims. The term "protected purchaser," which replaces the term "bona fide purchaser" used in the prior version of Article 8, is derived from the term "protected holder" used in the Convention on International Bills and Notes prepared by the United Nations Commission on International Trade Law ("UNCITRAL").

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1)
"Certificated security". Section 8-102(a)(4)
"Control". Section 8-106
"Notice of adverse claim". Section 8-105
"Purchaser". Sections 1-201(33) & 8-116
"Uncertificated security". Section 8-102(a)(18)
"Value". Sections 1-201(44) & 8-116

ANNOTATION

Annotator's note. Since § 4-8-303 is similar to § 4-8-302 as it existed prior to the 1996 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Where evidence establishes that one had been informed that stock certificates were not validly issued before he accepted delivery, and that he had not acquired them for value and in good faith, he is not a bona fide purchaser. Folsom v. Security Nat'l Bank, 32 Colo. App. 91, 507 P.2d 1114 (1973).

Lenders were purchasers of security interest rather than bailees or holders of stock where stock owner voluntarily delivered and pledged stock as security for loans made to third parties and where lender gave value in exchange for pledge. Under the circumstances, lender was entitled to sell stock to recover losses upon third party default. Knappenberger v. Shea, 874 P.2d 498 (Colo. App. 1994).

Lenders were "bona fide purchasers" in absence of evidence that lender associated with or had notice of alleged fraud prior to completion of loan and stock transactions and in absence of evidence establishing unconscionability of stock pledge agreement. Knappenberger v. Shea, 874 P.2d 498 (Colo. App. 1994).

Lenders who were "bona fide purchasers" belonged to favored sub-class of purchasers who prevail against all other claimants in the exercise of security interest where stock pledge agreement specifically authorized lender to sell or transfer stock and retain profits in the event of loan default. Knappenberger v. Shea, 874 P.2d 498 (Colo. App. 1994).

A party requesting reissuance of a stock certificate cannot claim status as a purchaser for value. Am. Sec. Transfer, Inc. v. Pantheon Indus., Inc., 871 F. Supp. 400 (D. Colo. 1994).

Purchaser of limited tax bond was not a "protected purchaser" acquiring rights greater than the seller held because purchaser had prior notice of another's adverse claim. Meadow Homes Dev. Corp. v. Bowens, 211 P.3d 743 (Colo. App. 2009).

4-8-304. Indorsement. (a) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies to whom a security is to be transferred or who has power to transfer it. A holder may convert a blank indorsement to a special indorsement.

(b) An indorsement purporting to be only of part of a security certificate representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(c) An indorsement, whether special or in blank, does not constitute a transfer until delivery of the certificate on which it appears or, if the indorsement is on a separate document, until delivery of both the document and the certificate.

(d) If a security certificate in registered form has been delivered to a purchaser without a necessary indorsement, the purchaser may become a protected purchaser only when the indorsement is supplied. However, against a transferor, a transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

(e) An indorsement of a security certificate in bearer form may give notice of an adverse claim to the certificate, but it does not otherwise affect a right to registration that the holder possesses.

(f) Unless otherwise agreed, a person making an indorsement assumes only the obligations provided in section 4-8-108 and not an obligation that the security will be honored by the issuer.

Source: L. 96: Entire article R&RE, p. 221, § 2, effective July 1.

Editor's note: This section is similar to former §§ 4-8-307, 4-8-308, 4-8-309, and 4-8-310 as they existed prior to 1996.

OFFICIAL COMMENT

1. By virtue of the definition of indorsement in Section 8-102 and the rules of this section, the simplified method of indorsing certificated securities previously set forth in the Uniform Stock Transfer Act is continued. Although more than one special indorsement on a given security certificate is possible, the desire for dividends or interest, as the case may be, should operate to bring the certificate home for registration of transfer within a reasonable period of time. The usual form of assignment which appears on the back of a stock certificate or in a separate "power" may be filled up either in the form of an assignment, a power of attorney to transfer, or both. If it is not filled up at all but merely signed, the indorsement is in blank. If filled up either as an assignment or as a power of attorney to transfer, the indorsement is special.

2. Subsection (b) recognizes the validity of a "partial" indorsement, e.g., as to fifty shares of the one hundred represented by a single certificate. The rights of a transferee under a partial indorsement to the status of a protected purchaser are left to the case law.

3. Subsection (c) deals with the effect of an indorsement without delivery. There must be a voluntary parting with control in order to effect a valid transfer of a certificated security as between the parties. Levey v. Nason, 279 Mass. 268, 181 N.E. 193 (1932), and National Surety Co. v. Indemnity Insurance Co. of North America, 237 App.Div. 485, 261 N.Y.S. 605 (1933). The provision in Section 10 of the Uniform Stock Transfer Act that an attempted transfer without delivery amounts to a promise to transfer is omitted. Even under that Act the effect of such a promise was left to the applicable law of contracts, and this Article by making no reference to such situations intends to achieve a similar result. With respect to delivery there is no counterpart to subsection (d) on right to compel indorsement, such as is envisaged in Johnson v. Johnson, 300 Mass. 24, 13 N.E.2d 788 (1938), where the transferee under a written assignment was given the right to compel a transfer of the certificate.

4. Subsection (d) deals with the effect of delivery without indorsement. As between the parties the transfer is made complete upon delivery, but the transferee cannot become a protected purchaser until indorsement is made. The indorsement does not operate retroactively, and notice may intervene between delivery and indorsement so as to prevent the transferee from becoming a protected purchaser. Although a purchaser taking without a necessary indorsement may be subject to claims of ownership, any issuer's defense of which the purchaser had no notice at the time of delivery will be cut off, since the provisions of this Article protect all purchasers for value without notice (Section 8-202).

The transferee's right to compel an indorsement where a security certificate has been delivered with intent to transfer is recognized in the case law. See Coats v. Guaranty Bank & Trust Co., 170 La. 871, 129 So. 513 (1930). A proper indorsement is one of the requisites of transfer which a purchaser of a certificated security has a right to obtain (Section 8-307). A purchaser may not only compel an indorsement under that section but may also recover for any reasonable expense incurred by the transferor's failure to respond to the demand for an indorsement.

5. Subsection (e) deals with the significance of an indorsement on a security certificate in bearer form. The concept of indorsement applies only to registered securities. A purported indorsement of bearer paper is normally of no effect. An indorsement "for collection," "for surrender" or the like, charges a purchaser with notice of adverse claims (Section 8-105(d)) but does not operate beyond this to interfere with any right the holder may otherwise possess to have the security registered.

6. Subsection (f) makes clear that the indorser of a security certificate does not warrant that the issuer will honor the underlying obligation. In view of the nature of investment securities and the circumstances under which they are normally transferred, a transferor cannot be held to warrant as to the issuer's actions. As a transferor the indorser, of course, remains liable for breach of the warranties set forth in this Article (Section 8-108).

Definitional Cross References:

"Bearer form". Section 8-102(a)(2)
"Certificated security". Section 8-102(a)(4)
"Indorsement". Section 8-102(a)(11)
"Purchaser". Sections 1-201(33) & 8-116
"Registered form". Section 8-102(a)(13)
"Security certificate". Section 8-102(a)(16)

ANNOTATION

I. General Consideration.
II. Transfer.
III. Attempted Transfer Without Delivery.

I. GENERAL CONSIDERATION.

Law reviews. For note, "Attachment of Corporate Stock Where the Method is Not Prescribed by Statute", see 2 Rocky Mt. L. Rev. 190 (1930). For article, "When Corporate Stock Becomes Real Estate", see 21 Dicta 53 (1944). For article, "Application of the Uniform Stock Transfer Act to Gifts of Stock", see 20 Rocky Mt. L. Rev. 67 (1947). For article, "One Year Review of Agency, Partnerships, Corporations, and Municipal Corporations", see 41 Den. L. Ctr. J. 61 (1964). For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965).

II. TRANSFER.

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Title to corporate stock can only be transferred as provided by statute. Quandary Land Dev. Co. v. Porter, 159 Colo. 8, 408 P.2d 978 (1965).

The statutory methods are exclusive. Brennan v. W. A. Wills, Ltd., 263 F.2d 1 (10th Cir.), cert. denied, 360 U.S. 902, 79 S. Ct. 1284, 3 L. Ed.2d 1254 (1959); Goeddel v. Aircraft Fin., Inc., 152 Colo. 419, 382 P.2d 812 (1963); Quandary Land Dev. Co. v. Porter, 159 Colo. 8, 408 P.2d 978 (1965).

This section requires delivery of the certificate to effect a transfer of title. Brennan v. Korholz, 293 F.2d 751 (10th Cir. 1961).

Any attempt to transfer stock without delivery of the certificate does not have the effect of passing title, but merely constitutes a promise to transfer. Brennan v. W. A. Wills, Ltd., 263 F.2d 1 (10th Cir.), cert. denied, 360 U.S. 902, 79 S. Ct. 1284, 3 L. Ed.2d 1254 (1959); Goeddel v. Aircraft Fin., Inc., 152 Colo. 419, 382 P.2d 812 (1963); Quandary Land Dev. Co. v. Porter, 159 Colo. 8, 408 P.2d 978 (1965).

Under the uniform stock transfer act, title to a certificate and to the shares represented thereby could be transferred only by (1) delivery of the certificate indorsed either in blank or to a specified person by the person appearing by the certificate to be the owner of the shares represented thereby, or by (2) delivery of the certificate and a separate document containing a written assignment of the certificate or a power of attorney to sell, assign, or transfer the same or the shares represented thereby signed by the person appearing by the certificate to be the owner of the shares represented thereby. Brennan v. W. A. Wills, Ltd., 263 F.2d 1 (10th Cir.), cert. denied, 360 U.S. 902, 79 S. Ct. 1284, 3 L. Ed.2d 1254 (1959); Arfsten v. Higby, 150 Colo. 254, 372 P.2d 166 (1962); Goeddel v. Aircraft Fin., Inc., 152 Colo. 419, 382 P.2d 812 (1963).

An assignment of a shareholder's interest without delivery of the certificates operates to vest an equitable title in the assignee. Arfsten v. Higby, 150 Colo. 254, 372 P.2d 166 (1962).

Under prior stock transfer statutes the holder of an equitable title to stock had an

enforceable status, where rights of third parties were not involved. Arfsten v. Higby, 150 Colo. 254, 372 P.2d 166 (1962).

III. ATTEMPTED TRANSFER WITHOUT DELIVERY.

Law reviews. For article, "One Year Review of Agency, Partnerships, Corporations, and Municipal Corporations", see 41 Den. L. Ctr. J. 61 (1964).

For prior provisions making attempted transfers without delivery a matter of contract, see Brennan v. W. A. Wills, Ltd., 263 F.2d 1 (10th Cir.), cert. denied, 360 U.S. 902, 79 S. Ct. 1284, 3 L. Ed.2d 1254 (1959); Brennan v. Korholz, 293 F.2d 751 (10th Cir. 1961); Goeddel v. Aircraft Fin., Inc., 152 Colo. 419, 382 P.2d 812 (1963) (decided under repealed § 31-9-10, CRS 53, uniform stock transfer act).

4-8-305. Instruction. (a) If an instruction has been originated by an appropriate person but is incomplete in any other respect, any person may complete it as authorized and the issuer may rely on it as completed, even though it has been completed incorrectly.

(b) Unless otherwise agreed, a person initiating an instruction assumes only the obligations imposed by section 4-8-108 and not an obligation that the security will be honored by the issuer.

Source: L. 96: Entire article R&RE, p. 221, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-308 as it existed prior to 1996.

OFFICIAL COMMENT

1. The term instruction is defined in Section 8-102(a)(12) as a notification communicated to the issuer of an uncertificated security directing that transfer be registered. Section 8-107 specifies who may initiate an effective instruction.

Functionally, presentation of an instruction is quite similar to the presentation of an indorsed certificate for reregistration. Note that instruction is defined in terms of "communicate," see Section 8-102(a)(6). Thus, the instruction may be in the form of a writing signed by the registered owner or in any other form agreed upon by the issuer and the registered owner. Allowing nonwritten forms of instructions will permit the development and employment of means of transmitting instructions electronically.

When a person who originates an instruction leaves a blank and the blank later is completed, subsection (a) gives the issuer the same rights it would have had against the originating person had that person completed the blank. This is true regardless of whether the person completing the instruction had authority to complete it. Compare Section 8-206 and its Comment, dealing with blanks left upon issue.

2. Subsection (b) makes clear that the originator of an instruction, like the indorser of a security certificate, does not warrant that the issuer will honor the underlying obligation, but does make warranties as a transferor under Section 8-108.

Definitional Cross References:

"Appropriate person". Section 8-107
"Instruction". Section 8-102(a)(12)
"Issuer". Section 8-201

4-8-306. Effect of guaranteeing signature, indorsement, or instruction. (a) A person who guarantees a signature of an indorser of a security certificate warrants that at the time of signing:

(1) The signature was genuine;

(2) The signer was an appropriate person to indorse, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and

(3) The signer had legal capacity to sign.

(b) A person who guarantees a signature of the originator of an instruction warrants that at the time of signing:

(1) The signature was genuine;

(2) The signer was an appropriate person to originate the instruction, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person, if the person specified in the instruction as the registered owner was, in fact, the registered owner, as to which fact the signature guarantor does not make a warranty; and

(3) The signer had legal capacity to sign.

(c) A person who specially guarantees the signature of an originator of an instruction

makes the warranties of a signature guarantor under subsection (b) of this section and also warrants that at the time the instruction is presented to the issuer:

(1) The person specified in the instruction as the registered owner of the uncertificated security will be the registered owner; and

(2) The transfer of the uncertificated security requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction.

(d) A guarantor under subsections (a) and (b) of this section or a special guarantor under subsection (c) of this section does not otherwise warrant the rightfulness of the transfer.

(e) A person who guarantees an indorsement of a security certificate makes the warranties of a signature guarantor under subsection (a) of this section and also warrants the rightfulness of the transfer in all respects.

(f) A person who guarantees an instruction requesting the transfer of an uncertificated security makes the warranties of a special signature guarantor under subsection (c) of this section and also warrants the rightfulness of the transfer in all respects.

(g) An issuer may not require a special guaranty of signature, a guaranty of indorsement, or a guaranty of instruction as a condition to registration of transfer.

(h) The warranties under this section are made to a person taking or dealing with the security in reliance on the guaranty, and the guarantor is liable to the person for loss resulting from their breach. An indorser or originator of an instruction whose signature, indorsement, or instruction has been guaranteed is liable to a guarantor for any loss suffered by the guarantor as a result of breach of the warranties of the guarantor.

Source: L. 96: Entire article R&RE, p. 222, § 2, effective July 1.

Editor's note: This section is similar to former §§ 4-8-306 and 4-8-312 as they existed prior to 1996.

OFFICIAL COMMENT

1. Subsection (a) provides that a guarantor of the signature of the indorser of a security certificate warrants that the signature is genuine, that the signer is an appropriate person or has actual authority to indorse on behalf of the appropriate person, and that the signer has legal capacity. Subsection (b) provides similar, though not identical, warranties for the guarantor of a signature of the originator of an instruction for transfer of an uncertificated security.

Appropriate person is defined in Section 8-107(a) to include a successor or person who has power under other law to act for a person who is deceased or lacks capacity. Thus if a certificate registered in the name of Mary Roe is indorsed by Jane Doe as executor of Mary Roe, a guarantor of the signature of Jane Doe warrants that she has power to act as executor.

Although the definition of appropriate person in Section 8-107(a) does not itself include an agent, an indorsement by an agent is effective under Section 8-107(b) if the agent has authority to act for the appropriate person. Accordingly, this section provides an explicit warranty of authority for agents.

2. The rationale of the principle that a signature guarantor warrants the authority of the signer, rather than simply the genuineness of the signature, was explained in the leading case of Jennie Clarkson Home for Children v. Missouri, K. & T. R. Co., 182 N.Y. 47, 74 N.E. 571, 70 A.L.R. 787 (1905), which dealt with a guaranty of the signature of a person indorsing on behalf of a corporation. "If stock is held by an individual who is executing a power of attorney for its transfer, the member of the exchange who signs as a witness thereto guaranties not only the genuineness of the signature affixed to the power of attorney, but that the person signing is the individual in whose name the stock stands. With reference to stock standing in the name of a corporation, which can only sign a power of attorney through its authorized officers or agents, a different situation is presented. If the witnessing of the signature of the corporation is only that of the signature of a person who signs for the corporation, then the guaranty is of no value, and there is nothing to protect purchasers or the companies who are called upon to issue new stock in the place of that transferred from the frauds of persons who have signed the names of corporations without authority. If such is the only effect of the guaranty, purchasers and transfer agents must first go to the corporation in whose name the stock stands and ascertain whether the individual who signed the power of attorney had authority to so do. This will require time, and in many cases will necessitate the

postponement of the completion of the purchase by the payment of the money until the facts can be ascertained. The broker who is acting for the owner has an opportunity to become acquainted with his customer, and may readily before sale ascertain, in case of a corporation, the name of the officer who is authorized to execute the power of attorney. It was therefore, we think, the purpose of the rule to cast upon the broker who witnesses the signature the duty of ascertaining whether the person signing the name of the corporation had authority to so do, and making the witness a guarantor that it is the signature of the corporation in whose name the stock stands."

3. Subsection (b) sets forth the warranties that can reasonably be expected from the guarantor of the signature of the originator of an instruction, who, though familiar with the signer, does not have any evidence that the purported owner is in fact the owner of the subject uncertificated security. This is in contrast to the position of the person guaranteeing a signature on a certificate who can see a certificate in the signer's possession in the name of or indorsed to the signer or in blank. Thus, the warranty in paragraph (2) of subsection (b) is expressly conditioned on the actual registration's conforming to that represented by the originator. If the signer purports to be the owner, the guarantor under paragraph (2), warrants only the identity of the signer. If, however, the signer is acting in a representative capacity, the guarantor warrants both the signer's identity and authority to act for the purported owner. The issuer needs no warranty as to the facts of registration because those facts can be ascertained from the issuer's own records.

4. Subsection (c) sets forth a "special guaranty of signature" under which the guarantor additionally warrants both registered ownership and freedom from undisclosed defects of record. The guarantor of the signature of an indorser of a security certificate effectively makes these warranties to a purchaser for value on the evidence of a clean certificate issued in the name of the indorser, indorsed to the indorser or indorsed in blank. By specially guaranteeing under subsection (c), the guarantor warrants that the instruction will, when presented to the issuer, result in the requested registration free from defects not specified.

5. Subsection (d) makes clear that the warranties of a signature guarantor are limited to those specified in this section and do not include a general warranty of rightfulness. On the other hand subsections (e) and (f) provide that a person guaranteeing an indorsement or an instruction does warrant that the transfer is rightful in all respects.

6. Subsection (g) makes clear what can be inferred from the combination of Sections 8-401 and 8-402, that the issuer may not require as a condition to transfer a guaranty of the indorsement or instruction nor may it require a special signature guaranty.

7. Subsection (h) specifies to whom the warranties in this section run, and also provides that a person who gives a guaranty under this section has an action against the indorser or originator for any loss suffered by the guarantor.

Definitional Cross References:

"Appropriate person". Section 8-107
"Genuine". Section 1-201(18)
"Indorsement". Section 8-102(a)(11)
"Instruction". Section 8-102(a)(12)
"Issuer". Section 8-201
"Security certificate". Section 8-102(a)(16)
"Uncertificated security". Section 8-102(a)(18)

4-8-307. Purchaser's right to requisites for registration of transfer. Unless otherwise agreed, the transferor of a security on due demand shall supply the purchaser with proof of authority to transfer or with any other requisite necessary to obtain registration of the transfer of the security, but if the transfer is not for value, a transferor need not comply unless the purchaser pays the necessary expenses. If the transferor fails within a reasonable time to comply with the demand, the purchaser may reject or rescind the transfer.

Source: L. 96: Entire article R&RE, p. 223, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-316 as it existed prior to 1996.

OFFICIAL COMMENT

1. Because registration of the transfer of a security is a matter of vital importance, a purchaser is here provided with the means of obtaining such formal requirements for registration as signature guaranties, proof of authority, transfer tax stamps and the like. The transferor is the one in a position to supply most conveniently whatever documentation may be requisite for registration of transfer, and the duty to do so upon demand within a reasonable time is here stated affirmatively. If an essential item is peculiarly within the province of the transferor so that the transferor is the only one who can obtain it, the purchaser may specifically enforce the

right to obtain it. Compare Section 8-304(d). If a transfer is not for value the transferor need not pay expenses.

2. If the transferor's duty is not performed the transferee may reject or rescind the contract to transfer. The transferee is not bound to do so. An action for damages for breach of contract may be preferred.

Definitional Cross References:

"Purchaser". Sections 1-201(33) & 8-116
"Security". Section 8-102(a)(15)
"Value". Sections 1-201(44) & 8-116

PART 4

REGISTRATION

4-8-401. Duty of issuer to register transfer. (a) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security, the issuer shall register the transfer as requested if:

(1) Under the terms of the security the person seeking registration of transfer is eligible to have the security registered in its name;

(2) The indorsement or instruction is made by the appropriate person or by an agent who has actual authority to act on behalf of the appropriate person;

(3) Reasonable assurance is given that the indorsement or instruction is genuine and authorized (section 4-8-402);

(4) Any applicable law relating to the collection of taxes has been complied with;

(5) The transfer does not violate any restriction on transfer imposed by the issuer in accordance with section 4-8-204;

(6) A demand that the issuer not register transfer has not become effective under section 4-8-403, or the issuer has complied with section 4-8-403 (b) but no legal process or indemnity bond is obtained as provided in section 4-8-403 (d); and

(7) The transfer is in fact rightful or is to a protected purchaser.

(b) If an issuer is under a duty to register a transfer of a security, the issuer is liable to a person presenting a certificated security or an instruction for registration or to the person's principal for loss resulting from unreasonable delay in registration or failure or refusal to register the transfer.

Source: L. 96: Entire article R&RE, p. 223, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-401 as it existed prior to 1996.

OFFICIAL COMMENT

1. This section states the duty of the issuer to register transfers. A duty exists only if certain preconditions exist. If any of the preconditions do not exist, there is no duty to register transfer. If an indorsement on a security certificate is a forgery, there is no duty. If an instruction to transfer an uncertificated security is not originated by an appropriate person, there is no duty. If there has not been compliance with applicable tax laws, there is no duty. If a security certificate is properly indorsed but nevertheless the transfer is in fact wrongful, there is no duty unless the transfer is to a protected purchaser (and the other preconditions exist).

This section does not constitute a mandate that the issuer must establish that all preconditions are met before the issuer registers a transfer. The issuer may waive the reasonable assurances specified in paragraph (a)(3). If it has confidence in the responsibility of the persons requesting transfer, it may ignore questions of compliance with tax laws. Although an issuer has no duty if the transfer is wrongful, the issuer has no duty to inquire into adverse claims, see Section 8-404.

2. By subsection (b) the person entitled to registration may not only compel it but may hold the issuer liable in damages for unreasonable delay.

3. Section 8-201(c) provides that with respect to registration of transfer, "issuer" means the person on whose behalf transfer books are maintained. Transfer agents, registrars or the like within the scope of their respective functions have rights and duties under this Part similar to those of the issuer. See Section 8-407.

Definitional Cross References:

"Appropriate person". Section 8-107
"Certificated security". Section 8-102(a)(4)
"Genuine". Section 1-201(18)

"Indorsement". Section 8-102(a)(11)
"Instruction". Section 8-102(a)(12)
"Issuer". Section 8-201
"Protected purchaser". Section 8-303
"Registered form". Section 8-102(a)(13)
"Uncertificated security". Section 8-102(a)(18)

ANNOTATION

Annotator's note. The following annotations include cases decided under former provisions similar to this section.

Under this section an issuer has a duty to register the transfer of securities as requested if certain preconditions are clearly met. Dempsey-Tegeler & Co. v. Otis Oil & Gas Corp., 293 F. Supp. 1383 (D. Colo. 1968).

The transfer of cancelled certificates is not rightful. Where evidence establishes that stock certificates are no longer valid, having been cancelled on the books of the company, and no evidence is offered to contradict the correctness of the company records or to establish that the certificates are in fact valid, there is not a rightful transfer, since transfer of cancelled, invalidated, certificates does not constitute a rightful transfer. Folsom v. Security Nat'l Bank, 32 Colo. App. 91, 507 P.2d 1114 (1973).

The court could not conclude, as a matter of law, that a transfer agent was immune from liability absent a legal opinion that the proposed transfer was permissible. Am. Sec. Transfer, Inc. v. Pantheon Indus., Inc., 871 F. Supp. 400 (D. Colo. 1994).

Request to reissue a stock certificate without the restrictive legend is considered a "request to transfer shares" within the meaning of this section. Therefore it falls within the duties of § 4-8-406. Am. Sec. Transfer, Inc. v. Pantheon Indus., Inc., 871 F. Supp. 400 (D. Colo. 1994).

This section preempts common law remedies relating to the placement and removal of restrictive legends. Clancy Sys. Int'l, Inc. v. Salazar, 177 P.3d 1235 (Colo. 2008).

A party requesting reissuance of a stock certificate cannot claim status as a purchaser for value. Am. Sec. Transfer, Inc. v. Pantheon Indus., Inc., 871 F. Supp. 400 (D. Colo. 1994).

Former provisions voided all transfers unless they were recorded on the books of the company within 60 days. Conway v. John, 14 Colo. 30, 23 P. 170 (1890); Weber v. Bullock, 19 Colo. 214, 35 P. 183 (1893); First Nat'l Bank v. Hastings, 7 Colo. App. 129, 42 P. 691 (1895); Nat'l Bank v. Graham, 16 Colo. App. 498, 66 P. 684 (1901); Richardson v. Longmont Supply Ditch Co., 19 Colo. App. 483, 76 P. 546 (1904); Isbell v. Graybill, 19 Colo. App. 508, 76 P. 550 (1904); Equitable Sec. Co. v. Johnson, 36 Colo. 377, 85 P. 840 (1906); Pueblo Sav. Bank v. Richardson, 39 Colo. 319, 89P. 799 (1907); Central Sav. Bank v. Smith, 43 Colo. 90, 95 P. 307 (1908); O'Neil v. Wolcott Mining Co., 174 F. 527 (8th Cir. 1909); Shires v. Allen, 47 Colo. 440, 107 P. 1072 (1910); Ironstone Ditch Co. v. Equitable Sec. Co., 52 Colo. 268, 121 P. 174 (1911); Lucifer Coal Co. v. Buster, 64 Colo. 179, 171 P. 61 (1918); Carlton v. Camfield, 64 Colo. 373, 171 P. 1140 (1918); Hexter v. Shahan, 66 Colo. 156, 180 P. 92 (1919); Valleyview Consol. Gold Mining Co. v. Whitehead, 66 Colo. 237, 180 P. 737 (1919); Capitol Petroleum Co. v. Haldeman, 66 Colo. 265, 180 P. 758 (1919); Snider v. Bourquin, 68 Colo. 207, 188 P. 727 (1920); McClelland v. Merchants' & Miners' Nat'l Bank, 77 Colo. 302, 236 P. 774 (1925); Hawkins v. Hershey, 78 Colo. 539, 242 P. 975 (1925); Mulvihill v. First Nat'l Bank, 80 Colo. 72, 249 P. 504 (1926); Hollingsworth v. Multa Trina Ditch Co., 51 F.2d 649 (10th Cir. 1931); Hertz Drive-Ur-Self Sys. v. Doak, 94 Colo. 200, 29 P.2d 625 (1934) (decided under repealed C.L. 1921, § 2268 and laws antecedent thereto).

4-8-402. Assurance that indorsement or instruction is effective. (a) An issuer may require the following assurance that each necessary indorsement or each instruction is genuine and authorized:

(1) In all cases, a guaranty of the signature of the person making an indorsement or originating an instruction including, in the case of an instruction, reasonable assurance of identity;

(2) If the indorsement is made or the instruction is originated by an agent, appropriate assurance of actual authority to sign;

(3) If the indorsement is made or the instruction is originated by a fiduciary pursuant to section 4-8-107 (a) (4) or (a) (5), appropriate evidence of appointment or incumbency;

(4) If there is more than one fiduciary, reasonable assurance that all who are required to sign have done so; and

(5) If the indorsement is made or the instruction is originated by a person not covered by another provision of this subsection (a), assurance appropriate to the case corresponding as nearly as may be to the provisions of this subsection (a).

(b) An issuer may elect to require reasonable assurance beyond that specified in this section.

(c) In this section:

(1) "Guaranty of the signature" means a guaranty signed by or on behalf of a person reasonably believed by the issuer to be responsible. An issuer may adopt standards with respect to responsibility if they are not manifestly unreasonable.

(2) "Appropriate evidence of appointment or incumbency" means:

(i) In the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of the court or an officer thereof and dated within sixty days before the date of presentation for transfer; or

(ii) In any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by an issuer to be responsible or, in the absence of that document or certificate, other evidence the issuer reasonably considers appropriate.

Source: L. 96: Entire article R&RE, p. 223, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-402 as it existed prior to 1996.

OFFICIAL COMMENT

1. An issuer is absolutely liable for wrongful registration of transfer if the indorsement or instruction is ineffective. See Section 8-404. Accordingly, an issuer is entitled to require such assurance as is reasonable under the circumstances that all necessary indorsements are effective, and thus to minimize its risk. This section establishes the requirements the issuer may make in terms of documentation which, except in the rarest of instances, should be easily furnished. Subsection (b) provides that an issuer may require additional assurances if that requirement is reasonable under the circumstances, but if the issuer demands more than reasonable assurance that the instruction or the necessary indorsements are genuine and authorized, the presenter may refuse the demand and sue for improper refusal to register. Section 8-401(b).

2. Under subsection (a)(1), the issuer may require in all cases a guaranty of signature. See Section 8-306. When an instruction is presented the issuer always may require reasonable assurance as to the identity of the originator. Subsection (c) allows the issuer to require that the person making these guaranties be one reasonably believed to be responsible, and the issuer may adopt standards of responsibility which are not manifestly unreasonable. Regulations under the federal securities laws, however, place limits on the requirements transfer agents may impose concerning the responsibility of eligible signature guarantors. See 17 CFR 240.17Ad-15.

3. This section, by paragraphs (2) through (5) of subsection (a), permits the issuer to seek confirmation that the indorsement or instruction is genuine and authorized. The permitted methods act as a double check on matters which are within the warranties of the signature guarantor. See Section 8-306. Thus, an agent may be required to submit a power of attorney, a corporation to submit a certified resolution evidencing the authority of its signing officer to sign, an executor or administrator to submit the usual "short-form certificate," etc. But failure of a fiduciary to obtain court approval of the transfer or to comply with other requirements does not make the fiduciary's signature ineffective. Section 8-107(c). Hence court orders and other controlling instruments are omitted from subsection (a).

Subsection (a)(3) authorizes the issuer to require "appropriate evidence" of appointment or incumbency, and subsection (c) indicates what evidence will be "appropriate". In the case of a fiduciary appointed or qualified by a court that evidence will be a court certificate dated within sixty days before the date of presentation, subsection (c)(2)(i). Where the fiduciary is not appointed or qualified by a court, as in the case of a successor trustee, subsection (c)(2)(ii) applies. In that case, the issuer may require a copy of a trust instrument or other document showing the appointment, or it may require the certificate of a responsible person. In the absence of such a document or certificate, it may require other appropriate evidence. If the security is registered in the name of the fiduciary as such, the person's signature is effective even though the person is no longer serving in that capacity, see Section 8-107(d), hence no evidence of incumbency is needed.

4. Circumstances may indicate that a necessary signature was unauthorized or was not that of an appropriate person. Such circumstances would be ignored at risk of absolute liability. To minimize that risk the issuer may properly exercise the option given by subsection (b) to

require assurance beyond that specified in subsection (a). On the other hand, the facts at hand may reflect only on the rightfulness of the transfer. Such facts do not create a duty of inquiry, because the issuer is not liable to an adverse claimant unless the claimant obtains legal process. See Section 8-404.

Definitional Cross References:
"Appropriate person". Section 8-107
"Genuine". Section 1-201(18)
"Indorsement". Section 8-102(a)(11)
"Instruction". Section 8-102(a)(12)
"Issuer". Section 8-201

4-8-403. Demand that issuer not register transfer. (a) A person who is an appropriate person to make an indorsement or originate an instruction may demand that the issuer not register transfer of a security by communicating to the issuer a notification that identifies the registered owner and the issue of which the security is a part and provides an address for communications directed to the person making the demand. The demand is effective only if it is received by the issuer at a time and in a manner affording the issuer reasonable opportunity to act on it.

(b) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security after a demand that the issuer not register transfer has become effective, the issuer shall promptly communicate to (i) the person who initiated the demand at the address provided in the demand and (ii) the person who presented the security for registration of transfer or initiated the instruction requesting registration of transfer a notification stating that:

(1) The certificated security has been presented for registration of transfer or the instruction for registration of transfer of the uncertificated security has been received;

(2) A demand that the issuer not register transfer had previously been received; and

(3) The issuer will withhold registration of transfer for a period of time stated in the notification in order to provide the person who initiated the demand an opportunity to obtain legal process or an indemnity bond.

(c) The period described in subsection (b) (3) of this section may not exceed thirty days after the date of communication of the notification. A shorter period may be specified by the issuer if it is not manifestly unreasonable.

(d) An issuer is not liable to a person who initiated a demand that the issuer not register transfer for any loss the person suffers as a result of registration of a transfer pursuant to an effective indorsement or instruction if the person who initiated the demand does not, within the time stated in the issuer's communication, either:

(1) Obtain an appropriate restraining order, injunction, or other process from a court of competent jurisdiction enjoining the issuer from registering the transfer; or

(2) File with the issuer an indemnity bond, sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar, or other agent of the issuer involved from any loss it or they may suffer by refusing to register the transfer.

(e) This section does not relieve an issuer from liability for registering transfer pursuant to an indorsement or instruction that was not effective.

Source: L. 96: Entire article R&RE, p. 224, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-403 as it existed prior to 1996.

OFFICIAL COMMENT

1. The general rule under this Article is that if there has been an effective indorsement or instruction, a person who contends that registration of the transfer would be wrongful should not be able to interfere with the registration process merely by sending notice of the assertion to the issuer. Rather, the claimant must obtain legal process. See Section 8-404. Section 8-403 is an exception to this general rule. It permits the registered owner — but not third parties — to demand that the issuer not register a transfer.

2. This section is intended to alleviate the problems faced by registered owners of certificated securities who lose or misplace their certificates. A registered owner who realizes that a certificate may have been lost or stolen should promptly report that fact to the issuer, lest the

owner be precluded from asserting a claim for wrongful registration. See Section 8-406. The usual practice of issuers and transfer agents is that when a certificate is reported as lost, the owner is notified that a replacement can be obtained if the owner provides an indemnity bond. See Section 8-405. If the registered owner does not plan to transfer the securities, the owner might choose not to obtain a replacement, particularly if the owner suspects that the certificate has merely been misplaced.

Under this section, the owner's notification that the certificate has been lost would constitute a demand that the issuer not register transfer. No indemnity bond or legal process is necessary. If the original certificate is presented for registration of transfer, the issuer is required to notify the registered owner of that fact, and defer registration of transfer for a stated period. In order to prevent undue delay in the process of registration, the stated period may not exceed thirty days. This gives the registered owner an opportunity to either obtain legal process or post an indemnity bond and thereby prevent the issuer from registering transfer.

3. Subsection (e) makes clear that this section does not relieve an issuer from liability for registering a transfer pursuant to an ineffective indorsement. An issuer's liability for wrongful registration in such cases does not depend on the presence or absence of notice that the indorsement was ineffective. Registered owners who are confident that they neither indorsed the certificates, nor did anything that would preclude them from denying the effectiveness of another's indorsement, see Sections 8-107(b) and 8-406, might prefer to pursue their rights against the issuer for wrongful registration rather than take advantage of the opportunity to post a bond or seek a restraining order when notified by the issuer under this section that their lost certificates have been presented for registration in apparently good order.

Definitional Cross References:

"Appropriate person". Section 8-107
"Certificated security". Section 8-102(a)(4)
"Communicate". Section 8-102(a)(6)
"Effective". Section 8-107
"Indorsement". Section 8-102(a)(11)
"Instruction". Section 8-102(a)(12)
"Issuer". Section 8-201
"Registered form". Section 8-102(a)(13)
"Uncertificated security". Section 8-102(a)(18)

4-8-404. Wrongful registration. (a) Except as otherwise provided in section 4-8-406, an issuer is liable for wrongful registration of transfer if the issuer has registered a transfer of a security to a person not entitled to it, and the transfer was registered:

(1) Pursuant to an ineffective indorsement or instruction;

(2) After a demand that the issuer not register transfer became effective under section 4-8-403 (a) and the issuer did not comply with section 4-8-403 (b);

(3) After the issuer had been served with an injunction, restraining order, or other legal process enjoining it from registering the transfer, issued by a court of competent jurisdiction, and the issuer had a reasonable opportunity to act on the injunction, restraining order, or other legal process; or

(4) By an issuer acting in collusion with the wrongdoer.

(b) An issuer that is liable for wrongful registration of transfer under subsection (a) of this section on demand shall provide the person entitled to the security with a like certificated or uncertificated security, and any payments or distributions that the person did not receive as a result of the wrongful registration. If an overissue would result, the issuer's liability to provide the person with a like security is governed by section 4-8-210.

(c) Except as otherwise provided in subsection (a) of this section or in a law relating to the collection of taxes, an issuer is not liable to an owner or other person suffering loss as a result of the registration of a transfer of a security if registration was made pursuant to an effective indorsement or instruction.

Source: L. 96: Entire article R&RE, p. 226, § 2, effective July 1.

Editor's note: This section is similar to former §§ 4-8-311 and 4-8-404 as they existed prior to 1996.

OFFICIAL COMMENT

1. Subsection (a)(1) provides that an issuer is liable if it registers transfer pursuant to an indorsement or instruction that was not effective. For example, an issuer that registers transfer on a forged indorsement is liable to the registered owner. The fact that the issuer had no reason to

suspect that the indorsement was forged or that the issuer obtained the ordinary assurances under Section 8-402 does not relieve the issuer from liability. The reason that issuers obtain signature guaranties and other assurances is that they are liable for wrongful registration.

Subsection (b) specifies the remedy for wrongful registration. Pre-Code cases established the registered owner's right to receive a new security where the issuer had wrongfully registered a transfer, but some cases also allowed the registered owner to elect between an equitable action to compel issue of a new security and an action for damages. Cf. Casper v. Kalt-Zimmers Mfg. Co., 159 Wis. 517, 149 N.W. 754 (1914). Article 8 does not allow such election. The true owner of a certificated security is required to take a new security except where an overissue would result and a similar security is not reasonably available for purchase. See Section 8-210. The true owner of an uncertificated security is entitled and required to take restoration of the records to their proper state, with a similar exception for overissue.

2. Read together, subsections (c) and (a) have the effect of providing that an issuer has no duties to an adverse claimant unless the claimant serves legal process on the issuer to enjoin registration. Issuers, or their transfer agents, perform a record-keeping function for the direct holding system that is analogous to the functions performed by clearing corporations and securities intermediaries in the indirect holding system. This section applies to the record-keepers for the direct holding system the same standard that Section 8-115 applies to the record-keepers for the indirect holding system. Thus, issuers are not liable to adverse claimants merely on the basis of notice. As in the case of the analogous rules for the indirect holding system, the policy of this section is to protect the right of investors to have their securities transfers processed without the disruption or delay that might result if the record-keepers risked liability to third parties. It would be undesirable to apply different standards to the direct and indirect holding systems, since doing so might operate as a disincentive to the development of a book-entry direct holding system.

3. This section changes prior law under which an issuer could be held liable, even though it registered transfer on an effective indorsement or instruction, if the issuer had in some fashion been notified that the transfer might be wrongful against a third party, and the issuer did not appropriately discharge its duty to inquire into the adverse claim. See Section 8-403 (1978).

The rule of former Section 8-403 was anomalous inasmuch as Section 8-207 provides that the issuer is entitled to "treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner." Under Section 8-207, the fact that a third person notifies the issuer of a claim does not preclude the issuer from treating the registered owner as the person entitled to the security. See Kerrigan v. American Orthodontics Corp., 960 F.2d 43 (7th Cir. 1992). The change made in the present version of Section 8-404 ensures that the rights of registered owners and the duties of issuers with respect to registration of transfer will be protected against third-party interference in the same fashion as other rights of registered ownership.

Definitional Cross References:

"Certificated security". Section 8-102(a)(4)
"Effective". Section 8-107
"Indorsement". Section 8-102(a)(11)
"Instruction". Section 8-102(a)(12)
"Issuer". Section 8-201
"Security". Section 8-102(a)(15)
"Uncertificated security". Section 8-102(a)(18)

4-8-405. Replacement of lost, destroyed, or wrongfully taken security certificate. (a) If an owner of a certificated security, whether in registered or bearer form, claims that the certificate has been lost, destroyed, or wrongfully taken, the issuer shall issue a new certificate if the owner:

(1) So requests before the issuer has notice that the certificate has been acquired by a protected purchaser;

(2) Files with the issuer a sufficient indemnity bond; and

(3) Satisfies other reasonable requirements imposed by the issuer.

(b) If, after the issue of a new security certificate, a protected purchaser of the original certificate presents it for registration of transfer, the issuer shall register the transfer unless an overissue would result. In that case, the issuer's liability is governed by section 4-8-210. In addition to any rights on the indemnity bond, an issuer may recover the new certificate from a person to whom it was issued or any person taking under that person, except a protected purchaser.

Source: L. 96: Entire article R&RE, p. 226, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-405 as it existed prior to 1996.

OFFICIAL COMMENT

1. This section enables the owner to obtain a replacement of a lost, destroyed or stolen certificate, provided that reasonable requirements are satisfied and a sufficient indemnity bond supplied.

2. Where an "original" security certificate has reached the hands of a protected purchaser, the registered owner — who was in the best position to prevent the loss, destruction or theft of the security certificate — is now deprived of the new security certificate issued as a replacement. This changes the pre-UCC law under which the original certificate was ineffective after the issue of a replacement except insofar as it might represent an action for damages in the hands of a purchaser for value without notice. Keller v. Eureka Brick Mach. Mfg. Co., 43 Mo.App. 84, 11 L.R.A. 472 (1890). Where both the original and the new certificate have reached protected purchasers the issuer is required to honor both certificates unless an overissue would result and the security is not reasonably available for purchase. See Section 8-210. In the latter case alone, the protected purchaser of the original certificate is relegated to an action for damages. In either case, the issuer itself may recover on the indemnity bond.

Definitional Cross References:
"Bearer form". Section 8-102(a)(2)
"Certificated security". Section 8-102(a)(4)
"Issuer". Section 8-201
"Notice". Section 1-201(25)
"Overissue". Section 8-210
"Protected purchaser". Section 8-303
"Registered form". Section 8-102(a)(13)
"Security certificate". Section 8-102(a)(16)

4-8-406. Obligation to notify issuer of lost, destroyed, or wrongfully taken security certificate. If a security certificate has been lost, apparently destroyed, or wrongfully taken, and the owner fails to notify the issuer of that fact within a reasonable time after the owner has notice of it and the issuer registers a transfer of the security before receiving notification, the owner may not assert against the issuer a claim for registering the transfer under section 4-8-404 or a claim to a new security certificate under section 4-8-405.

Source: L. 96: Entire article R&RE, p. 227, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-405 as it existed prior to 1996.

OFFICIAL COMMENT

An owner who fails to notify the issuer within a reasonable time after the owner knows or has reason to know of the loss or theft of a security certificate is estopped from asserting the ineffectiveness of a forged or unauthorized indorsement and the wrongfulness of the registration of the transfer. If the lost certificate was indorsed by the owner, then the registration of the transfer was not wrongful under Section 8-404, unless the owner made an effective demand that the issuer not register transfer under Section 8-403.

Definitional Cross References:
"Issuer". Section 8-201
"Notify". Section 1-201(25)
"Security certificate". Section 8-102(a)(16)

4-8-407. Authenticating trustee, transfer agent, and registrar. A person acting as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of a transfer of its securities, in the issue of new security certificates or uncertificated securities, or in the cancellation of surrendered security certificates has the same obligation to the holder or owner of a certificated or uncertificated security with regard to the particular functions performed as the issuer has in regard to those functions.

Source: L. 96: Entire article R&RE, p. 227, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-406 as it existed prior to 1996.

OFFICIAL COMMENT

1. Transfer agents, registrars, and the like are here expressly held liable both to the issuer and to the owner for wrongful refusal to register a transfer as well as for wrongful registration of a

transfer in any case within the scope of their respective functions where the issuer would itself be liable. Those cases which have regarded these parties solely as agents of the issuer and have therefore refused to recognize their liability to the owner for mere non-feasance, i.e., refusal to register a transfer, are rejected. Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944); Nicholson v. Morgan, 119 Misc. 309, 196 N.Y.Supp. 147 (1922); Lewis v. Hargadine-McKittrick Dry Goods Co., 305 Mo. 396, 274 S.W. 1041 (1924).

2. The practice frequently followed by authenticating trustees of issuing certificates of indebtedness rather than authenticating duplicate certificates where securities have been lost or stolen became obsolete in view of the provisions of Section 8-405, which makes express provision for the issue of substitute securities. It is not a breach of trust or lack of due diligence for trustees to authenticate new securities. Cf. Switzerland General Ins. Co. v. N.Y.C. & H.R.R. Co., 152 App.Div. 70, 136 N.Y.S. 726 (1912).

Definitional Cross References:

"Certificated security". Section 8-102(a)(4)
"Issuer". Section 8-201
"Security". Section 8-102(a)(15)
"Security certificate". Section 8-102(a)(16)
"Uncertificated security". Section 8-102(a)(18)

ANNOTATION

Request to reissue a stock certificate without the restrictive legend is considered a "request to transfer shares" within the meaning of § 4-8-401. Therefore it falls within the duties of this section. Am. Sec. Transfer, Inc. v. Pantheon Indus., Inc., 871 F. Supp. 400 (D. Colo. 1994) (decided under former § 4-8-406 as it existed prior to the 1996 repeal and reenactment of this article).

PART 5

SECURITY ENTITLEMENTS

4-8-501. Securities account - acquisition of security entitlement from securities intermediary. (a) "Securities account" means an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.

(b) Except as otherwise provided in subsections (d) and (e) of this section, a person acquires a security entitlement if a securities intermediary:

(1) Indicates by book entry that a financial asset has been credited to the person's securities account;

(2) Receives a financial asset from the person or acquires a financial asset for the person and, in either case, accepts it for credit to the person's securities account; or

(3) Becomes obligated under other law, regulation, or rule to credit a financial asset to the person's securities account.

(c) If a condition of subsection (b) of this section has been met, a person has a security entitlement even though the securities intermediary does not itself hold the financial asset.

(d) If a securities intermediary holds a financial asset for another person, and the financial asset is registered in the name of, payable to the order of, or specially indorsed to the other person, and has not been indorsed to the securities intermediary or in blank, the other person is treated as holding the financial asset directly rather than as having a security entitlement with respect to the financial asset.

(e) Issuance of a security is not establishment of a security entitlement.

Source: L. 96: Entire article R&RE, p. 227, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-313 as it existed prior to 1996.

OFFICIAL COMMENT

1. Part 5 rules apply to security entitlements, and Section 8-501(b) provides that a person has a security entitlement when a financial asset has been credited to a "securities account." Thus, the term "securities account" specifies the type of arrangements between institutions and their customers that are covered by Part 5. A securities account is a consensual arrangement in which the intermediary undertakes to treat the customer as entitled to exercise the rights that comprise the financial asset. The consensual aspect is covered by the requirement that the account be established pursuant to agreement. The term agreement is used in the broad sense defined in Section 1-201(3). There is no requirement that a formal or written agreement be signed.

As the securities business is presently conducted, several significant relationships clearly fall within the definition of a securities account, including the relationship between a clearing corporation and its participants, a broker and customers who leave securities with the broker, and a bank acting as securities custodian and its custodial customers. Given the enormous variety of arrangements concerning securities that exist today, and the certainty that new arrangements will evolve in the future, it is not possible to specify all of the arrangements to which the term does and does not apply.

Whether an arrangement between a firm and another person concerning a security or other financial asset is a "securities account" under this Article depends on whether the firm has undertaken to treat the other person as entitled to exercise the rights that comprise the security or other financial asset. Section 1-102, however, states the fundamental principle of interpretation that the Code provisions should be construed and applied to promote their underlying purposes and policies. Thus, the question whether a given arrangement is a securities account should be decided not by dictionary analysis of the words of the definition taken out of context, but by considering whether it promotes the objectives of Article 8 to include the arrangement within the term securities account.

The effect of concluding that an arrangement is a securities account is that the rules of Part 5 apply. Accordingly, the definition of "securities account" must be interpreted in light of the substantive provisions in Part 5, which describe the core features of the type of relationship for which the commercial law rules of Revised Article 8 concerning security entitlements were designed. There are many arrangements between institutions and other persons concerning securities or other financial assets which do not fall within the definition of "securities account" because the institutions have not undertaken to treat the other persons as entitled to exercise the ordinary rights of an entitlement holder specified in the Part 5 rules. For example, the term securities account does not cover the relationship between a bank and its depositors or the relationship between a trustee and the beneficiary of an ordinary trust, because those are not relationships in which the holder of a financial asset has undertaken to treat the other as entitled to exercise the rights that comprise the financial asset in the fashion contemplated by the Part 5 rules.

In short, the primary factor in deciding whether an arrangement is a securities account is whether application of the Part 5 rules is consistent with the expectations of the parties to the relationship. Relationships not governed by Part 5 may be governed by other parts of Article 8 if the relationship gives rise to a new security, or may be governed by other law entirely.

2. Subsection (b) of this section specifies what circumstances give rise to security entitlements. Paragraph (1) of subsection (b) sets out the most important rule. It turns on the intermediary's conduct, reflecting a basic operating assumption of the indirect holding system that once a securities intermediary has acknowledged that it is carrying a position in a financial asset for its customer or participant, the intermediary is obligated to treat the customer or participant as entitled to the financial asset. Paragraph (1) does not attempt to specify exactly what accounting, record-keeping, or information transmission steps suffice to indicate that the intermediary has credited the account. That is left to agreement, trade practice, or rule in order to provide the flexibility necessary to accommodate varying or changing accounting and information processing systems. The point of paragraph (1) is that once an intermediary has acknowledged that it is carrying a position for the customer or participant, the customer or participant has a security entitlement. The precise form in which the intermediary manifests that acknowledgment is left to private ordering.

Paragraph (2) of subsection (b) sets out a different operational test, turning not on the intermediary's accounting system but on the facts that accounting systems are supposed to represent. Under paragraph (b)(2) a person has a security entitlement if the intermediary has received and accepted a financial asset for credit to the account of its customer or participant. For example, if a customer of a broker or bank custodian delivers a security certificate in proper form to the broker or bank to be held in the customer's account, the customer acquires a security entitlement. Paragraph (b)(2) also covers circumstances in which the intermediary receives a financial asset from a third person for credit to the account of the customer or participant. Paragraph (b)(2) is not limited to circum-

stances in which the intermediary receives security certificates or other financial assets in physical form. Paragraph (b)(2) also covers circumstances in which the intermediary acquires a security entitlement with respect to a financial asset which is to be credited to the account of the intermediary's own customer. For example, if a customer transfers her account from Broker A to Broker B, she acquires security entitlements against Broker B once the clearing corporation has credited the positions to Broker B's account. It should be noted, however, that paragraph (b)(2) provides that a person acquires a security entitlement when the intermediary not only receives but also accepts the financial asset for credit to the account. This limitation is included to take account of the fact that there may be circumstances in which an intermediary has received a financial asset but is not willing to undertake the obligations that flow from establishing a security entitlement. For example, a security certificate which is sent to an intermediary may not be in proper form, or may represent a type of financial asset which the intermediary is not willing to carry for others. It should be noted that in all but extremely unusual cases, the circumstances covered by paragraph (2) will also be covered by paragraph (1), because the intermediary will have credited the positions to the customer's account.

Paragraph (3) of subsection (b) sets out a residual test, to avoid any implication that the failure of an intermediary to make the appropriate entries to credit a position to a customer's securities account would prevent the customer from acquiring the rights of an entitlement holder under Part 5. As is the case with the paragraph (2) test, the paragraph (3) test would not be needed for the ordinary cases, since they are covered by paragraph (1).

3. In a sense, Section 8-501(b) is analogous to the rules set out in the provisions of Sections 8-313(1)(d) and 8-320 of the prior version of Article 8 that specified what acts by a securities intermediary or clearing corporation sufficed as a transfer of securities held in fungible bulk. Unlike the prior version of Article 8, however, this section is not based on the idea that an entitlement holder acquires rights only by virtue of a "transfer" from the securities intermediary to the entitlement holder. In the indirect holding system, the significant fact is that the securities intermediary has undertaken to treat the customer as entitled to the financial asset. It is up to the securities intermediary to take the necessary steps to ensure that it will be able to perform its undertaking. It is, for example, entirely possible that a securities intermediary might make entries in a customer's account reflecting that customer's acquisition of a certain security at a time when the securities intermediary did not itself happen to hold any units of that security. The person from whom the securities intermediary bought the security might have failed to deliver and it might have taken some time to clear up the problem, or there may have been an operational gap in time between the crediting of a customer's account and the receipt of securities from another securities intermediary. The entitlement holder's rights against the securities intermediary do not depend on whether or when the securities intermediary acquired its interests. Subsection (c) is intended to make this point clear. Subsection (c) does not mean that the intermediary is free to create security entitlements without itself holding sufficient financial assets to satisfy its entitlement holders. The duty of a securities intermediary to maintain sufficient assets is governed by Section 8-504 and regulatory law. Subsection (c) is included only to make it clear the question whether a person has acquired a security entitlement does not depend on whether the intermediary has complied with that duty.

4. Part 5 of Article 8 sets out a carefully designed system of rules for the indirect holding system. Persons who hold securities through brokers or custodians have security entitlements that are governed by Part 5, rather than being treated as the direct holders of securities. Subsection (d) specifies the limited circumstance in which a customer who leaves a financial asset with a broker or other securities intermediary has a direct interest in the financial asset, rather than a security entitlement.

The customer can be a direct holder only if the security certificate, or other financial asset, is registered in the name of, payable to the order of, or specially indorsed to the customer, and has not been indorsed by the customer to the securities intermediary or in blank. The distinction between those circumstances where the customer can be treated as direct owner and those where the customer has a security entitlement is essentially the same as the distinction drawn under the federal bankruptcy code between customer name securities and customer property. The distinction does not turn on any form of physical identification or segregation. A customer who delivers certificates to a broker with blank indorsements or stock powers is not a direct holder but has a security entitlement, even though the broker holds those certificates in some form of separate safe-keeping arrangement for that particular customer. The customer remains the direct holder only if there is no indorsement or stock power so that further action by the customer is required to place the certificates in a form where they can be transferred by the broker.

The rule of subsection (d) corresponds to the rule set out in Section 8-301(a)(3) specifying when acquisition of possession of a certificate by a securities intermediary counts as "delivery" to the customer.

5. Subsection (e) is intended to make clear that Part 5 does not apply to an arrangement in which a security is issued representing an interest in underlying assets, as distinguished from arrangements in which the underlying assets are carried in a securities account. A common mechanism by which new financial instruments are devised is that a financial institution that holds some security, financial instrument, or pool thereof, creates interests in that asset or pool which are sold to others. In many such cases, the interests so created will fall within the definition of "security" in Section 8-102(a)(15). If so, then by virtue of subsection (e) of Section 8-501, the relationship between the institution that creates the interests and the persons who hold them is not a security entitlement to which the Part 5 rules apply. Accordingly, an arrangement such as an American depositary receipt facility which creates freely transferable interests in underlying securities will be issuance of a security under Article 8 rather than establishment of a security entitlement to the underlying securities.

The subsection (e) rule can be regarded as an aspect of the definitional rules specifying the meaning of securities account and security entitlement. Among the key components of the definition of security in Section 8-102(a)(15) are the "transferability" and "divisibility" tests. Securities, in the Article 8 sense, are fungible interests or obligations that are intended to be tradable. The concept of security entitlement under Part 5 is quite different. A security entitlement is the package of rights that a person has against the person's own intermediary with respect to the positions carried in the person's securities account. That package of rights is not, as such, something that is traded. When a customer sells a security that she had held through a securities account, her security entitlement is terminated; when she buys a security that she will hold through her securities account, she acquires a security entitlement. In most cases, settlement of a securities trade will involve termination of one person's security entitlement and acquisition of a security entitlement by another person. That transaction, however, is not a "transfer" of the same entitlement from one person to another. That is not to say that an entitlement holder cannot transfer an interest in her security entitlement as such; granting a security interest in a security entitlement is such a transfer. On the other hand, the nature of a security entitlement is that the intermediary is undertaking duties only to the person identified as the entitlement holder.

Definitional Cross References:

"Financial asset". Section 8-102(a)(9)
"Indorsement". Section 8-102(a)(11)
"Securities intermediary". Section 8-102(a)(14)
"Security". Section 8-102(a)(15)
"Security entitlement". Section 8-102(a)(17)

4-8-502. Assertion of adverse claim against entitlement holder. An action based on an adverse claim to a financial asset, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who acquires a security entitlement under section 4-8-501 for value and without notice of the adverse claim.

Source: L. 96: Entire article R&RE, p. 228, § 2, effective July 1.

OFFICIAL COMMENT

1. The section provides investors in the indirect holding system with protection against adverse claims by specifying that no adverse claim can be asserted against a person who acquires a security entitlement under Section 8-501 for value and without notice of the adverse claim. It plays a role in the indirect holding system analogous to the rule of the direct holding system that protected purchasers take free from adverse claims (Section 8-303).

This section does not use the locution "takes free from adverse claims" because that could be confusing as applied to the indirect holding system. The nature of indirect holding system is that an entitlement holder has an interest in common with others who hold positions in the same financial asset through the same intermediary. Thus, a particular entitlement holder's interest in the financial assets held by its intermediary is necessarily "subject to" the interests of others. See Section 8-503. The rule stated in this section might have been expressed by saying that a person who acquires a security entitlement under Section 8-501 for value and without notice of adverse claims takes "that security entitlement" free from adverse claims. That formulation has not been used, however, for fear that it would be misinterpreted as suggesting that the person acquires a right to the underlying financial assets that could not be affected by the competing rights of others claiming through common or higher tier intermediaries. A security entitlement is a complex bundle of rights. This section does not deal with the question of what rights are in the bundle. Rather, this section provides that once a person has acquired the bundle, someone else cannot take it away on the basis of assertion that the transaction in which

the security entitlement was created involved a violation of the claimant's rights.

2. Because securities trades are typically settled on a net basis by book-entry movements, it would ordinarily be impossible for anyone to trace the path of any particular security, no matter how the interest of parties who hold through intermediaries is described. Suppose, for example, that S has a 1000 share position in XYZ common stock through an account with a broker, Able & Co. S's identical twin impersonates S and directs Able to sell the securities. That same day, B places an order with Baker & Co., to buy 1000 shares of XYZ common stock. Later, S discovers the wrongful act and seeks to recover "her shares." Even if S can show that, at the stage of the trade, her sell order was matched with B's buy order, that would not suffice to show that "her shares" went to B. Settlement between Able and Baker occurs on a net basis for all trades in XYZ that day; indeed Able's net position may have been such that it received rather than delivered shares in XYZ through the settlement system.

In the unlikely event that this was the only trade in XYZ common stock executed in the market that day, one could follow the shares from S's account to B's account. The plaintiff in an action in conversion or similar legal action to enforce a property interest must show that the defendant has an item of property that belongs to the plaintiff. In this example, B's security entitlement is not the same item of property that formerly was held by S, it is a new package of rights that B acquired against Baker under Section 8-501. Principles of equitable remedies might, however, provide S with a basis for contending that if the position B received was the traceable product of the wrongful taking of S's property by S's twin, a constructive trust should be imposed on B's property in favor of S. See G. Palmer, The Law of Restitution § 2.14. Section 8-502 ensures that no such claims can be asserted against a person, such as B in this example, who acquires a security entitlement under Section 8-501 for value and without notice, regardless of what theory of law or equity is used to describe the basis of the assertion of the adverse claim.

In the above example, S would ordinarily have no reason to pursue B unless Able is insolvent and S's claim will not be satisfied in the insolvency proceedings. Because S did not give an entitlement order for the disposition of her security entitlement, Able must recredit her account for the 1000 shares of XYZ common stock. See Section 8-507(b).

3. The following examples illustrate the operation of Section 8-502.

Example 1. Thief steals bearer bonds from Owner. Thief delivers the bonds to Broker for credit to Thief's securities account, thereby acquiring a security entitlement under Section 8-501(b). Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Because Thief was himself the wrongdoer, Thief obviously had notice of Owner's adverse claim. Accordingly, Section 8-502 does not preclude Owner from asserting an adverse claim against Thief.

Example 2. Thief steals bearer bonds from Owner. Thief owes a personal debt to Creditor. Creditor has a securities account with Broker. Thief agrees to transfer the bonds to Creditor as security for or in satisfaction of his debt to Creditor. Thief does so by sending the bonds to Broker for credit to Creditor's securities account. Creditor thereby acquires a security entitlement under Section 8-501(b). Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Creditor acquired the security entitlement for value, since Creditor acquired it as security for or in satisfaction of Thief's debt to Creditor. See Section 1-201(44). If Creditor did not have notice of Owner's claim, Section 8-502 precludes any action by Owner against Creditor, whether framed in constructive trust or other theory. Section 8-105 specifies what counts as notice of an adverse claim.

Example 3. Father, as trustee for Son, holds XYZ Co. shares in a securities account with Able & Co. In violation of his fiduciary duties, Father sells the XYZ Co. shares and uses the proceeds for personal purposes. Father dies, and his estate is insolvent. Assume — implausibly — that Son is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 precludes any action by Son against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 4. Debtor holds XYZ Co. shares in a securities account with Able & Co. As collateral for a loan from Bank, Debtor grants Bank a security interest in the security entitlement to the XYZ Co. shares. Bank perfects by a method which leaves Debtor with the ability to dispose of the shares. See Section 9-115. In violation of the security agreement, Debtor sells the XYZ Co. shares and absconds with the proceeds. Assume — implausibly — that Bank is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 precludes any action by Bank against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 5. Debtor owns controlling interests in various public companies, including Acme and Ajax. Acme owns 60% of the stock of another public company, Beta. Debtor causes the Beta stock to be pledged to Lending Bank as collateral for Ajax's debt. Acme holds the Beta stock through an account with a securities custodian, C Bank, which in turn holds through Clearing Corporation. Lending Bank is also a Clearing Corporation participant. The pledge of the Beta stock is implemented by Acme instructing C Bank to instruct Clearing Corporation to debit C Bank's account and credit Lending Bank's account. Acme and Ajax both become insolvent. The Beta stock is still valuable. Acme's liquidator asserts that the pledge of the Beta stock for Ajax's debt was wrongful as against Acme and seeks to recover the Beta stock from Lending Bank. Because the pledge was implemented by an outright transfer into Lending Bank's account at Clearing Corporation, Lending Bank acquired a security entitlement to the Beta stock under Section 8-501. Lending Bank acquired the security entitlement for value, since it acquired it as security for a debt. See Section 1-201(44). If Lending Bank did not have notice of Acme's claim, Section 8-502 will preclude any action by Acme against Lending Bank, whether framed in constructive trust or other theory.

4. Although this section protects entitlement holders against adverse claims, it does not protect them against the risk that their securities intermediary will not itself have sufficient financial assets to satisfy the claims of all of its entitlement holders. Suppose that Customer A holds 1000 shares of XYZ Co. stock in an account with her broker, Able & Co. Able in turn holds 1000 shares of XYZ Co. through its account with Clearing Corporation, but has no other positions in XYZ Co. shares, either for other customers or for its own proprietary account. Customer B places an order with Able for the purchase of 1000 shares of XYZ Co. stock, and pays the purchase price. Able credits B's account with a 1000 share position in XYZ Co. stock, but Able does not itself buy any additional XYZ Co. shares. Able fails, having only 1000 shares to satisfy the claims of A and B. Unless other insolvency law establishes a different distributional rule, A and B would share the 1000 shares held by Able pro rata, without regard to the time that their respective entitlements were established. See Section 8-503(b). Section 8-502 protects entitlement holders, such as A and B, against adverse claimants. In this case, however, the problem that A and B face is not that someone is trying to take away their entitlements, but that the entitlements are not worth what they thought. The only role that Section 8-502 plays in this case is to preclude any assertion that A has some form of claim against B by virtue of the fact that Able's establishment of an entitlement in favor of B diluted A's rights to the limited assets held by Able.

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1)
"Financial asset". Section 8-102(a)(9)
"Notice of adverse claim". Section 8-105
"Security entitlement". Section 8-102(a)(17)
"Value". Sections 1-201(44) & 8-116

4-8-503. Property interest of entitlement holder in financial asset held by securities intermediary. (a) To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in section 4-8-511.

(b) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section is a pro rata property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset.

(c) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section may be enforced against the securities intermediary only by exercise of the entitlement holder's rights under sections 4-8-505 through 4-8-508.

(d) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section may be enforced against a purchaser of the financial asset or interest therein only if:

(1) Insolvency proceedings have been initiated by or against the securities intermediary;

(2) The securities intermediary does not have sufficient interests in the financial asset to satisfy the security entitlements of all of its entitlement holders to that financial asset;

(3) The securities intermediary violated its obligations under section 4-8-504 by transferring the financial asset or interest therein to the purchaser; and

(4) The purchaser is not protected under subsection (e) of this section. The trustee or other liquidator, acting on behalf of all entitlement holders having security entitlements with respect to a particular financial asset, may recover the financial asset, or interest therein, from the purchaser. If the trustee or other liquidator elects not to pursue that right, an entitlement holder whose security entitlement remains unsatisfied has the right to recover its interest in the financial asset from the purchaser.

(e) An action based on the entitlement holder's property interest with respect to a particular financial asset under subsection (a) of this section, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against any purchaser of a financial asset or interest therein who gives value, obtains control, and does not act in collusion with the securities intermediary in violating the securities intermediary's obligations under section 4-8-504.

Source: L. 96: Entire article R&RE, p. 228, § 2, effective July 1.

Editor's note: This section is similar to former § 4-8-313 as it existed prior to 1996.

OFFICIAL COMMENT

1. This section specifies the sense in which a security entitlement is an interest in the property held by the securities intermediary. It expresses the ordinary understanding that securities that a firm holds for its customers are not general assets of the firm subject to the claims of creditors. Since securities intermediaries generally do not segregate securities in such fashion that one could identify particular securities as the ones held for customers, it would not be realistic for this section to state that "customers' securities" are not subject to creditors' claims. Rather subsection (a) provides that to the extent necessary to satisfy all customer claims, all units of that security held by the firm are held for the entitlement holders, are not property of the securities intermediary, and are not subject to creditors' claims, except as otherwise provided in Section 8-511.

An entitlement holder's property interest under this section is an interest with respect to a specific issue of securities or financial assets. For example, customers of a firm who have positions in XYZ common stock have security entitlements with respect to the XYZ common stock held by the intermediary, while other customers who have positions in ABC common stock have security entitlements with respect to the ABC common stock held by the intermediary.

Subsection (b) makes clear that the property interest described in subsection (a) is an interest held in common by all entitlement holders who have entitlements to a particular security or other financial asset. Temporal factors are irrelevant. One entitlement holder cannot claim that its rights to the assets held by the intermediary are superior to the rights of another entitlement holder by virtue of having acquired those rights before, or after, the other entitlement holder. Nor does it matter whether the intermediary had sufficient assets to satisfy all entitlement holders' claims at one point, but no longer does. Rather, all entitlement holders have a pro rata interest in whatever positions in that financial asset the intermediary holds.

Although this section describes the property interest of entitlement holders in the assets held by the intermediary, it does not necessarily determine how property held by a failed intermediary will be distributed in insolvency proceedings. If the intermediary fails and its affairs are being administered in an insolvency proceeding, the applicable insolvency law governs how the various parties having claims against the firm are treated. For example, the distributional rules for stockbroker liquidation proceedings under the Bankruptcy Code and Securities Investor Protection Act ("SIPA") provide that all customer property is distributed pro rata among all customers in proportion to the dollar value of their total positions, rather than dividing the property on an issue by issue basis. For intermediaries that are not subject to the Bankruptcy Code and SIPA, other insolvency law would determine what distributional rule is applied.

2. Although this section recognizes that the entitlement holders of a securities intermediary have a property interest in the financial assets held by the intermediary, the incidents of this property interest are established by the rules of Article 8, not by common law property concepts. The traditional Article 8 rules on certificated securities were based on the idea that a paper certificate could be regarded as a nearly complete reification of the underlying right. The rules on transfer and the consequences of wrongful transfer could then be written using the same basic concepts as the rules for physical chattels. A person's claim of ownership of a certificated security is a right to a specific identifiable physical object, and that right can be asserted against any person who ends up in possession of that physical certificate, unless cut

off by the rules protecting purchasers for value without notice. Those concepts do not work for the indirect holding system. A security entitlement is not a claim to a specific identifiable thing; it is a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary. The idea that discrete objects might be traced through the hands of different persons has no place in the Revised Article 8 rules for the indirect holding system. The fundamental principles of the indirect holding system rules are that an entitlement holder's own intermediary has the obligation to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the financial asset, and that the entitlement holder can look only to that intermediary for performance of the obligations. The entitlement holder cannot assert rights directly against other persons, such as other intermediaries through whom the intermediary holds the positions, or third parties to whom the intermediary may have wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the wrongdoing. Subsections (c) through (e) reflect these fundamental principles.

Subsection (c) provides that an entitlement holder's property interest can be enforced against the intermediary only by exercise of the entitlement holder's rights under Sections 8-505 through 8-508. These are the provisions that set out the duty of an intermediary to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the security. If the intermediary is in insolvency proceedings and can no longer perform in accordance with the ordinary Part 5 rules, the applicable insolvency law will determine how the intermediary's assets are to be distributed.

Subsections (d) and (e) specify the limited circumstances in which an entitlement holder's property interest can be asserted against a third person to whom the intermediary transferred a financial asset that was subject to the entitlement holder's claim when held by the intermediary. Subsection (d) provides that the property interest of entitlement holders cannot be asserted against any transferee except in the circumstances therein specified. So long as the intermediary is solvent, the entitlement holders must look to the intermediary to satisfy their claims. If the intermediary does not hold financial assets corresponding to the entitlement holders' claims, the intermediary has the duty to acquire them. See Section 8-504. Thus, paragraphs (1), (2), and (3) of subsection (d) specify that the only occasion in which the entitlement holders can pursue transferees is when the intermediary is unable to perform its obligation, and the transfer to the transferee was a violation of those obligations. Even in that case, a transferee who gave value and obtained control is protected by virtue of the rule in subsection (e), unless the transferee acted in collusion with the intermediary.

Subsections (d) and (e) have the effect of protecting transferees from an intermediary against adverse claims arising out of assertions by the intermediary's entitlement holders that the intermediary acted wrongfully in transferring the financial assets. These rules, however, operate in a slightly different fashion than traditional adverse claim cut-off rules. Rather than specifying that a certain class of transferee takes free from all claims, subsections (d) and (e) specify the circumstances in which this particular form of claim can be asserted against a transferee. Revised Article 8 also contains general adverse claim cut-off rules for the indirect holding system. See Sections 8-502 and 8-510. The rule of subsections (d) and (e) takes precedence over the general cut-off rules of those sections, because Section 8-503 itself defines and sets limits on the assertion of the property interest of entitlement holders. Thus, the question whether entitlement holders' property interest can be asserted as an adverse claim against a transferee from the intermediary is governed by the collusion test of Section 8-503(e), rather than by the "without notice" test of Sections 8-502 and 8-510.

3. The limitations that subsections (c) through (e) place on the ability of customers of a failed intermediary to recover securities or other financial assets from transferees are consistent with the fundamental policies of investor protection that underlie this Article and other bodies of law governing the securities business. The commercial law rules for the securities holding and transfer system must be assessed from the forward-looking perspective of their impact on the vast number of transactions in which no wrongful conduct occurred or will occur, rather than from the post hoc perspective of what rule might be most advantageous to a particular class of persons in litigation that might arise out of the occasional case in which someone has acted wrongfully. Although one can devise hypothetical scenarios where particular customers might find it advantageous to be able to assert rights against someone other than the customers' own intermediary, commercial law rules that permitted customers to do so would impair rather than promote the interest of investors and the safe and efficient operation of the clearance and settlement system. Suppose, for example, that Intermediary A transfers securities to B, that Intermediary A acted wrongfully as against its customers in so doing, and that after the transaction Intermediary A did not have sufficient securities to satisfy its obligations to its entitlement holders. Viewed solely from the standpoint of the customers of Intermediary A, it would seem that permitting the property to be recovered from B, would be good for investors.

That, however, is not the case. B may itself be an intermediary with its own customers, or may be some other institution through which individuals invest, such as a pension fund or investment company. There is no reason to think that rules permitting customers of an intermediary to trace and recover securities that their intermediary wrongfully transferred work to the advantage of investors in general. To the contrary, application of such rules would often merely shift losses from one set of investors to another. The uncertainties that would result from rules permitting such recoveries would work to the disadvantage of all participants in the securities markets.

The use of the collusion test in Section 8-503(e) furthers the interests of investors generally in the sound and efficient operation of the securities holding and settlement system. The effect of the choice of this standard is that customers of a failed intermediary must show that the transferee from whom they seek to recover was affirmatively engaged in wrongful conduct, rather than casting on the transferee any burden of showing that the transferee had no awareness of wrongful conduct by the failed intermediary. The rule of Section 8-503(e) is based on the long-standing policy that it is undesirable to impose upon purchasers of securities any duty to investigate whether their sellers may be acting wrongfully.

Rather than imposing duties to investigate, the general policy of the commercial law of the securities holding and transfer system has been to eliminate legal rules that might induce participants to conduct investigations of the authority of persons transferring securities on behalf of others for fear that they might be held liable for participating in a wrongful transfer. The rules in Part 4 of Article 8 concerning transfers by fiduciaries provide a good example. Under Lowry v. Commercial & Farmers' Bank, 15 F. Cas. 1040 (C.C.D. Md. 1848) (No. 8551), an issuer could be held liable for wrongful transfer if it registered transfer of securities by a fiduciary under circumstances where it had any reason to believe that the fiduciary may have been acting improperly. In one sense that seems to be advantageous for beneficiaries who might be harmed by wrongful conduct by fiduciaries. The consequence of the Lowry rule, however, was that in order to protect against risk of such liability, issuers developed the practice of requiring extensive documentation for fiduciary stock transfers, making such transfers cumbersome and time consuming. Accordingly, the rules in Part 4 of Article 8, and in the prior fiduciary transfer statutes, were designed to discourage transfer agents from conducting investigations into the rightfulness of transfers by fiduciaries.

The rules of Revised Article 8 implement for the indirect holding system the same policies that the rules on protected purchasers and registration of transfer adopt for the direct holding system. A securities intermediary is, by definition, a person who is holding securities on behalf of other persons. There is nothing unusual or suspicious about a transaction in which a securities intermediary sells securities that it was holding for its customers. That is exactly what securities intermediaries are in business to do. The interests of customers of securities intermediaries would not be served by a rule that required counterparties to transfers from securities intermediaries to investigate whether the intermediary was acting wrongfully against its customers. Quite the contrary, such a rule would impair the ability of securities intermediaries to perform the function that customers want.

The rules of Section 8-503(c) through (e) apply to transferees generally, including pledgees. The reasons for treating pledgees in the same fashion as other transferees are discussed in the Comments to Section 8-511. The statement in subsection (a) that an intermediary holds financial assets for customers and not as its own property does not, of course, mean that the intermediary lacks power to transfer the financial assets to others. For example, although Article 9 provides that for a security interest to attach the debtor must have "rights" in the collateral, see Section 9-203, the fact that an intermediary is holding a financial asset in a form that permits ready transfer means that it has such rights, even if the intermediary is acting wrongfully against its entitlement holders in granting the security interest. The question whether the secured party takes subject to the entitlement holder's claim in such a case is governed by Section 8-511, which is an application to secured transactions of the general principles expressed in subsections (d) and (e) of this section.

Definitional Cross References:

"Control". Section 8-106
"Entitlement holder". Section 8-102(a)(7)
"Financial asset". Section 8-102(a)(9)
"Insolvency proceedings". Section 1-201(22)
"Purchaser". Sections 1-201(33) & 8-116
"Securities intermediary". Section 8-102(a)(14)
"Security entitlement". Section 8-102(a)(17)
"Value". Sections 1-201(44) & 8-116

4-8-504. Duty of securities intermediary to maintain financial asset. (a) A securities intermediary shall promptly obtain and thereafter maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset. The securities interme-

diary may maintain those financial assets directly or through one or more other securities intermediaries.

(b) Except to the extent otherwise agreed by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain pursuant to subsection (a) of this section.

(c) A securities intermediary satisfies the duty in subsection (a) of this section if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset.

(d) This section does not apply to a clearing corporation that is itself the obligor of an option or similar obligation to which its entitlement holders have security entitlements.

Source: L. 96: Entire article R&RE, p. 229, § 2, effective July 1.

OFFICIAL COMMENT

1. This section expresses one of the core elements of the relationships for which the Part 5 rules were designed, to wit, that a securities intermediary undertakes to hold financial assets corresponding to the security entitlements of its entitlement holders. The locution "shall promptly obtain and shall thereafter maintain" is taken from the corresponding regulation under federal securities law, 17 C.F.R. § 240.15c3-3. This section recognizes the reality that as the securities business is conducted today, it is not possible to identify particular securities as belonging to customers as distinguished from other particular securities that are the firm's own property. Securities firms typically keep all securities in fungible form, and may maintain their inventory of a particular security in various locations and forms, including physical securities held in vaults or in transit to transfer agents, and book entry positions at one or more clearing corporations. Accordingly, this section states that a securities intermediary shall maintain a quantity of financial assets corresponding to the aggregate of all security entitlements it has established. The last sentence of subsection (a) provides explicitly that the securities intermediary may hold directly or indirectly. That point is implicit in the use of the term "financial asset," inasmuch as Section 8-102(a)(9) provides that the term "financial asset" may refer either to the underlying asset or the means by which it is held, including both security certificates and security entitlements.

2. Subsection (b) states explicitly a point that is implicit in the notion that a securities intermediary must maintain financial assets corresponding to the security entitlements of its entitlement holders, to wit, that it is wrongful for a securities intermediary to grant security interests in positions that it needs to satisfy customers' claims, except as authorized by the customers. This statement does not determine the rights of a secured party to whom a securities intermediary wrongfully grants a security interest; that issue is governed by Sections 8-503 and 8-511.

Margin accounts are common examples of arrangements in which an entitlement holder authorizes the securities intermediary to grant security interests in the positions held for the entitlement holder. Securities firms commonly obtain the funds needed to provide margin loans to their customers by "rehypothecating" the customers' securities. In order to facilitate rehypothecation, agreements between margin customers and their brokers commonly authorize the broker to commingle securities of all margin customers for rehypothecation to the lender who provides the financing. Brokers commonly rehypothecate customer securities having a value somewhat greater than the amount of the loan made to the customer, since the lenders who provide the necessary financing to the broker need some cushion of protection against the risk of decline in the value of the rehypothecated securities. The extent and manner in which a firm may rehypothecate customers' securities are determined by the agreement between the intermediary and the entitlement holder and by applicable regulatory law. Current regulations under the federal securities laws require that brokers obtain the explicit consent of customers before pledging customer securities or commingling different customers' securities for pledge. Federal regulations also limit the extent to which a broker may rehypothecate customer securities to 110% of the aggregate amount of the borrowings of all customers.

3. The statement in this section that an intermediary must obtain and maintain financial assets corresponding to the aggregate of all security entitlements it has established is intended only to capture the general point that one of the key elements that distinguishes securities accounts from other relationships, such as deposit accounts, is that the intermediary undertakes to maintain a direct correspondence between the positions it holds and the claims of its customers. This section is not intended as a detailed specification of precisely how the intermediary

is to perform this duty, nor whether there may be special circumstances in which an intermediary's general duty is excused. Accordingly, the general statement of the duties of a securities intermediary in this and the following sections is supplemented by two other provisions. First, each of Sections 8-504 through 8-508 contains an "agreement/due care" provision. Second, Section 8-509 sets out general qualifications on the duties stated in these sections, including the important point that compliance with corresponding regulatory provisions constitutes compliance with the Article 8 duties.

4. The "agreement/due care" provision in subsection (c) of this section is necessary to provide sufficient flexibility to accommodate the general duty stated in subsection (a) to the wide variety of circumstances that may be encountered in the modern securities holding system. For the most common forms of publicly traded securities, the modern depository-based indirect holding system has made the likelihood of an actual loss of securities remote, though correctable errors in accounting or temporary interruptions of data processing facilities may occur. Indeed, one of the reasons for the evolution of book-entry systems is to eliminate the risk of loss or destruction of physical certificates. There are, however, some forms of securities and other financial assets which must still be held in physical certificated form, with the attendant risk of loss or destruction. Risk of loss or delay may be a more significant consideration in connection with foreign securities. An American securities intermediary may well be willing to hold a foreign security in a securities account for its customer, but the intermediary may have relatively little choice of or control over foreign intermediaries through which the security must in turn be held. Accordingly, it is common for American securities intermediaries to disclaim responsibility for custodial risk of holding through foreign intermediaries.

Subsection (c)(1) provides that a securities intermediary satisfies the duty stated in subsection (a) if the intermediary acts with respect to that duty in accordance with the agreement between the intermediary and the entitlement holder. Subsection (c)(2) provides that if there is no agreement on the matter, the intermediary satisfies the subsection (a) duty if the intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset in question. This formulation does not state that the intermediary has a universally applicable statutory duty of due care. Section 1-102(3) provides that statutory duties of due care cannot be disclaimed by agreement, but the "agreement/due care" formula contemplates that there may be particular circumstances where the parties do not wish to create a specific duty of due care, for example, with respect to foreign securities. Under subsection (c)(1), compliance with the agreement constitutes satisfaction of the subsection (a) duty, whether or not the agreement provides that the intermediary will exercise due care.

In each of the sections where the "agreement/due care" formula is used, it provides that entering into an agreement and performing in accordance with that agreement is a method by which the securities intermediary may satisfy the statutory duty stated in that section. Accordingly, the general obligation of good faith performance of statutory and contract duties, see Sections 1-203 and 8-102(a)(10), would apply to such an agreement. It would not be consistent with the obligation of good faith performance for an agreement to purport to establish the usual sort of arrangement between an intermediary and entitlement holder, yet disclaim altogether one of the basic elements that define that relationship. For example, an agreement stating that an intermediary assumes no responsibilities whatsoever for the safekeeping any of the entitlement holder's securities positions would not be consistent with good faith performance of the intermediary's duty to obtain and maintain financial assets corresponding to the entitlement holder's security entitlements.

To the extent that no agreement under subsection (c)(1) has specified the details of the intermediary's performance of the subsection (a) duty, subsection (c)(2) provides that the intermediary satisfies that duty if it exercises due care in accordance with reasonable commercial standards. The duty of care includes both care in the intermediary's own operations and care in the selection of other intermediaries through whom the intermediary holds the assets in question. The statement of the obligation of due care is meant to incorporate the principles of the common law under which the specific actions or precautions necessary to meet the obligation of care are determined by such factors as the nature and value of the property, the customs and practices of the business, and the like.

5. This section necessarily states the duty of a securities intermediary to obtain and maintain financial assets only at the very general and abstract level. For the most part, these matters are specified in great detail by regulatory law. Broker-dealers registered under the federal securities laws are subject to detailed regulation concerning the safeguarding of customer securities. See 17 C.F.R. § 240.15c3-3. Section 8-509(a) provides explicitly that if a securities intermediary complies with such regulatory law, that constitutes compliance with Section 8-504. In certain circumstances, these rules permit a firm to be in a position where it temporarily lacks a sufficient quantity of financial assets to satisfy all customer claims. For example, if another firm has failed to make a delivery to the firm in settlement of a trade, the firm is permitted a certain period of time to clear up the

problem before it is obligated to obtain the necessary securities from some other source.

6. Subsection (d) is intended to recognize that there are some circumstances, where the duty to maintain a sufficient quantity of financial assets does not apply because the intermediary is not holding anything on behalf of others. For example, the Options Clearing Corporation is treated as a "securities intermediary" under this Article, although it does not itself hold options on behalf of its participants. Rather, it becomes the issuer of the options, by virtue of guaranteeing the obligations of participants in the clearing corporation who have written or purchased the options cleared through it. See Section 8-103(e). Accordingly, the general duty of an intermediary under subsection (a) does not apply, nor would other provisions of Part 5 that depend upon the existence of a requirement that the securities intermediary hold financial assets, such as Sections 8-503 and 8-508.

Definitional Cross References:

"Agreement". Section 1-201(3)

"Clearing corporation". Section 8-102(a)(5)

"Entitlement holder". Section 8-102(a)(7)

"Financial asset". Section 8-102(a)(9)

"Securities intermediary". Section 8-102(a)(14)

"Security entitlement". Section 8-102(a)(17)

4-8-505. Duty of securities intermediary with respect to payments and distributions. (a) A securities intermediary shall take action to obtain a payment or distribution made by the issuer of a financial asset. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to attempt to obtain the payment or distribution.

(b) A securities intermediary is obligated to its entitlement holder for a payment or distribution made by the issuer of a financial asset if the payment or distribution is received by the securities intermediary.

Source: L. 96: Entire article R&RE, p. 230, § 2, effective July 1.

OFFICIAL COMMENT

1. One of the core elements of the securities account relationships for which the Part 5 rules were designed is that the securities intermediary passes through to the entitlement holders the economic benefit of ownership of the financial asset, such as payments and distributions made by the issuer. Subsection (a) expresses the ordinary understanding that a securities intermediary will take appropriate action to see to it that any payments or distributions made by the issuer are received. One of the main reasons that investors make use of securities intermediaries is to obtain the services of a professional in performing the record-keeping and other functions necessary to ensure that payments and other distributions are received.

2. Subsection (a) incorporates the same "agreement/due care" formula as the other provisions of Part 5 dealing with the duties of a securities intermediary. See Comment 4 to Section 8-504. This formulation permits the parties to specify by agreement what action, if any, the intermediary is to take with respect to the duty to obtain payments and distributions. In the absence of specification by agreement, the intermediary satisfies the duty if the intermediary exercises due care in accordance with reasonable commercial standards. The provisions of Section 8-509 also apply to the Section 8-505 duty, so that compliance with applicable regulatory requirements constitutes compliance with the Section 8-505 duty.

3. Subsection (b) provides that a securities intermediary is obligated to its entitlement holder for those payments or distributions made by the issuer that are in fact received by the intermediary. It does not deal with the details of the time and manner of payment. Moreover, as with any other monetary obligation, the obligation to pay may be subject to other rights of the obligor, by way of set-off counterclaim or the like. Section 8-509(c) makes this point explicit.

Definitional Cross References:

"Agreement". Section 1-201(3)

"Entitlement holder". Section 8-102(a)(7)

"Financial asset". Section 8-102(a)(9)

"Securities intermediary". Section 8-102(a)(14)

"Security entitlement". Section 8-102(a)(17)

4-8-506. Duty of securities intermediary to exercise rights as directed by entitlement holder. A securities intermediary shall exercise rights with respect to a financial asset if directed to do so by an entitlement holder. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary either places the entitlement holder in a position to exercise the rights directly or exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

Source: L. 96: Entire article R&RE, p. 230, § 2, effective July 1.

OFFICIAL COMMENT

1. Another of the core elements of the securities account relationships for which the Part 5 rules were designed is that although the intermediary may, by virtue of the structure of the indirect holding system, be the party who has the power to exercise the corporate and other rights that come from holding the security, the intermediary exercises these powers as representative of the entitlement holder rather than at its own discretion. This characteristic is one of the things that distinguishes a securities account from other arrangements where one person holds securities "on behalf of" another, such as the relationship between a mutual fund and its shareholders or a trustee and its beneficiary.

2. The fact that the intermediary exercises the rights of security holding as representative of the entitlement holder does not, of course, preclude the entitlement holder from conferring discretionary authority upon the intermediary. Arrangements are not uncommon in which investors do not wish to have their intermediaries forward proxy materials or other information. Thus, this section provides that the intermediary shall exercise corporate and other rights "if directed to do so" by the entitlement holder. Moreover, as with the other Part 5 duties, the "agreement/due care" formulation is used in stating how the intermediary is to perform this duty. This section also provides that the intermediary satisfies the duty if it places the entitlement holder in a position to exercise the rights directly. This is to take account of the fact that some of the rights attendant upon ownership of the security, such as rights to bring derivative and other litigation, are far removed from the matters that intermediaries are expected to perform.

3. This section, and the two that follow, deal with the aspects of securities holding that are related to investment decisions. For example, one of the rights of holding a particular security that would fall within the purview of this section would be the right to exercise a conversion right for a convertible security. It is quite common for investors to confer discretionary authority upon another person, such as an investment adviser, with respect to these rights and other investment decisions. Because this section, and the other sections of Part 5, all specify that a securities intermediary satisfies the Part 5 duties if it acts in accordance with the entitlement holder's agreement, there is no inconsistency between the statement of duties of a securities intermediary and these common arrangements.

4. Section 8-509 also applies to the Section 8-506 duty, so that compliance with applicable regulatory requirements constitutes compliance with this duty. This is quite important in this context, since the federal securities laws establish a comprehensive system of regulation of the distribution of proxy materials and exercise of voting rights with respect to securities held through brokers and other intermediaries. By virtue of Section 8-509(a), compliance with such regulatory requirement constitutes compliance with the Section 8-506 duty.

Definitional Cross References:

"Agreement". Section 1-201(3)

"Entitlement holder". Section 8-102(a)(7)

"Financial asset". Section 8-102(a)(9)

"Securities intermediary". Section 8-102(a)(14)

"Security entitlement". Section 8-102(a)(17)

4-8-507. Duty of securities intermediary to comply with entitlement order. (a) A securities intermediary shall comply with an entitlement order if the entitlement order is originated by the appropriate person, the securities intermediary has had reasonable opportunity to assure itself that the entitlement order is genuine and authorized, and the securities intermediary has had reasonable opportunity to comply with the entitlement order. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to comply with the entitlement order.

(b) If a securities intermediary transfers a financial asset pursuant to an ineffective entitlement order, the securities intermediary shall reestablish a security entitlement in favor

of the person entitled to it, and pay or credit any payments or distributions that the person did not receive as a result of the wrongful transfer. If the securities intermediary does not reestablish a security entitlement, the securities intermediary is liable to the entitlement holder for damages.

Source: L. 96: Entire article R&RE, p. 230, § 2, effective July 1.

OFFICIAL COMMENT

1. Subsection (a) of this section states another aspect of duties of securities intermediaries that make up security entitlements — the securities intermediary's duty to comply with entitlement orders. One of the main reasons for holding securities through securities intermediaries is to enable rapid transfer in settlement of trades. Thus the right to have one's orders for disposition of the security entitlement honored is an inherent part of the relationship. Subsection (b) states the correlative liability of a securities intermediary for transferring a financial asset from an entitlement holder's account pursuant to an entitlement order that was not effective.

2. The duty to comply with entitlement orders is subject to several qualifications. The intermediary has a duty only with respect to an entitlement order that is in fact originated by the appropriate person. Moreover, the intermediary has a duty only if it has had reasonable opportunity to assure itself that the order is genuine and authorized, and reasonable opportunity to comply with the order. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries, and the rules of Section 8-509 apply to the Section 8-507 duty.

3. Appropriate person is defined in Section 8-107. In the usual case, the appropriate person is the entitlement holder, see Section 8-107(a)(3). Entitlement holder is defined in Section 8-102(a)(7) as the person "identified in the records of a securities intermediary as the person having a security entitlement." Thus, the general rule is that an intermediary's duty with respect to entitlement orders runs only to the person with whom the intermediary has established a relationship. One of the basic principles of the indirect holding system is that securities intermediaries owe duties only to their own customers. See also Section 8-115. The only situation in which a securities intermediary has a duty to comply with entitlement orders originated by a person other than the person with whom the intermediary established a relationship is covered by Section 8-107(a)(4) and (a)(5), which provide that the term "appropriate person" includes the successor or personal representative of a decedent, or the custodian or guardian of a person who lacks capacity. If the entitlement holder is competent, another person does not fall within the defined term "appropriate person" merely by virtue of having power to act as an agent for the entitlement holder. Thus, an intermediary is not required to determine at its peril whether a person who purports to be authorized to act for an entitlement holder is in fact authorized to do so. If an entitlement holder wishes to be able to act through agents, the entitlement holder can establish appropriate arrangements in advance with the securities intermediary.

One important application of this principle is that if an entitlement holder grants a security interest in its security entitlements to a third-party lender, the intermediary owes no duties to the secured party, unless the intermediary has entered into a "control" agreement in which it agrees to act on entitlement orders originated by the secured party. See Section 8-106. Even though the security agreement or some other document may give the secured party authority to act as agent for the debtor, that would not make the secured party an "appropriate person" to whom the security intermediary owes duties. If the entitlement holder and securities intermediary have agreed to such a control arrangement, then the intermediary's action in following instructions from the secured party would satisfy the subsection (a) duty. Although an agent, such as the secured party in this example, is not an "appropriate person," an entitlement order is "effective" if originated by an authorized person. See Section 8-107(a) and (b). Moreover, Section 8-507(a) provides that the intermediary satisfies its duty if it acts in accordance with the entitlement holder's agreement.

4. Subsection (b) provides that an intermediary is liable for a wrongful transfer if the entitlement order was "ineffective." Section 8-107 specifies whether an entitlement order is effective. An "effective entitlement order" is different from an "entitlement order originated by an appropriate person." An entitlement order is effective under Section 8-107(b) if it is made by the appropriate person, or by a person who has power to act for the appropriate person under the law of agency, or if the appropriate person has ratified the entitlement order or is precluded from denying its effectiveness. Thus, although a securities intermediary does not have a duty to act on an entitlement order originated by the entitlement holder's agent, the intermediary is not liable for wrongful transfer if it does so.

Subsection (b), together with Section 8-107, has the effect of leaving to other law most of the questions of the sort dealt with by Article 4A for wire transfers of funds, such as allocation between the securities intermediary and the entitlement holder of the risk of fraudulent entitlement orders.

5. The term entitlement order does not cover all directions that a customer might give a broker concerning securities held through the broker. Article 8 is not a codification of all of the law of customers and stockbrokers. Article 8 deals with the settlement of securities trades, not the trades. The term entitlement order does not refer to instructions to a broker to make trades, that is, enter into contracts for the purchase or sale of securities. Rather, the entitlement order is the mechanism of transfer for securities held through intermediaries, just as indorsements and instructions are the mechanism for securities held directly. In the ordinary case the customer's direction to the broker to deliver the securities at settlement is implicit in the customer's instruction to the broker to sell. The distinction is, however, significant in that this section has no application to the relationship between the customer and broker with respect to the trade itself. For example, assertions by a customer that it was damaged by a broker's failure to execute a trading order sufficiently rapidly or in the proper manner are not governed by this Article.

Definitional Cross References:

"Agreement". Section 1-201(3)
"Appropriate person". Section 8-107
"Effective". Section 8-107
"Entitlement holder". Section 8-102(a)(7)
"Entitlement order". Section 8-102(a)(8)
"Financial asset". Section 8-102(a)(9)
"Securities intermediary". Section 8-102(a)(14)
"Security entitlement". Section 8-102(a)(17)

4-8-508. Duty of securities intermediary to change entitlement holder's position to other form of security holding. A securities intermediary shall act at the direction of an entitlement holder to change a security entitlement into another available form of holding for which the entitlement holder is eligible, or to cause the financial asset to be transferred to a securities account of the entitlement holder with another securities intermediary. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts as agreed upon by the entitlement holder and the securities intermediary; or

(2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

Source: L. 96: Entire article R&RE, p. 231, § 2, effective July 1.

OFFICIAL COMMENT

1. This section states another aspect of the duties of securities intermediaries that make up security entitlements — the obligation of the securities intermediary to change an entitlement holder's position into any other form of holding for which the entitlement holder is eligible or to transfer the entitlement holder's position to an account at another intermediary. This section does not state unconditionally that the securities intermediary is obligated to turn over a certificate to the customer or to cause the customer to be registered on the books of the issuer, because the customer may not be eligible to hold the security directly. For example, municipal bonds are now commonly issued in "book-entry only" form, in which the only entity that the issuer will register on its own books is a depository.

If security certificates in registered form are issued for the security, and individuals are eligible to have the security registered in their own name, the entitlement holder can request that the intermediary deliver or cause to be delivered to the entitlement holder a certificate registered in the name of the entitlement holder or a certificate indorsed in blank or specially indorsed to the entitlement holder. If security certificates in bearer form are issued for the security, the entitlement holder can request that the intermediary deliver or cause to be delivered a certificate in bearer form. If the security can be held by individuals directly in uncertificated form, the entitlement holder can request that the security be registered in its name. The specification of this duty does not determine the pricing terms of the agreement in which the duty arises.

2. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries. So too, the rules of Section 8-509 apply to the Section 8-508 duty.

Definitional Cross References:
"Agreement". Section 1-201(3)
"Entitlement holder". Section 8-102(a)(7)
"Financial asset". Section 8-102(a)(9)
"Securities intermediary". Section 8-102(a)(14)
"Security entitlement". Section 8-102(a)(17)

4-8-509. Specification of duties of securities intermediary by other statute or regulation - manner of performance of duties of securities intermediary and exercise of rights of entitlement holder. (a) If the substance of a duty imposed upon a securities intermediary by sections 4-8-504 through 4-8-508 is the subject of other statute, regulation, or rule, compliance with that statute, regulation, or rule satisfies the duty.

(b) To the extent that specific standards for the performance of the duties of a securities intermediary or the exercise of the rights of an entitlement holder are not specified by other statute, regulation, or rule or by agreement between the securities intermediary and entitlement holder, the securities intermediary shall perform its duties and the entitlement holder shall exercise its rights in a commercially reasonable manner.

(c) The obligation of a securities intermediary to perform the duties imposed by sections 4-8-504 through 4-8-508 is subject to:

(1) Rights of the securities intermediary arising out of a security interest under a security agreement with the entitlement holder or otherwise; and

(2) Rights of the securities intermediary under other law, regulation, rule, or agreement to withhold performance of its duties as a result of unfulfilled obligations of the entitlement holder to the securities intermediary.

(d) Sections 4-8-504 through 4-8-508 do not require a securities intermediary to take any action that is prohibited by other statute, regulation, or rule.

Source: L. 96: Entire article R&RE, p. 231, § 2, effective July 1.

OFFICIAL COMMENT

This Article is not a comprehensive statement of the law governing the relationship between broker-dealers or other securities intermediaries and their customers. Most of the law governing that relationship is the common law of contract and agency, supplemented or supplanted by regulatory law. This Article deals only with the most basic commercial/property law principles governing the relationship. Although Sections 8-504 through 8-508 specify certain duties of securities intermediaries to entitlement holders, the point of these sections is to identify what it means to have a security entitlement, not to specify the details of performance of these duties.

For many intermediaries, regulatory law specifies in great detail the intermediary's obligations on such matters as safekeeping of customer property, distribution of proxy materials, and the like. To avoid any conflict between the general statement of duties in this Article and the specific statement of intermediaries' obligations in such regulatory schemes, subsection (a) provides that compliance with applicable regulation constitutes compliance with the duties specified in Sections 8-504 through 8-508.

Definitional Cross References:
"Agreement". Section 1-201(3)
"Entitlement holder". Section 8-102(a)(7)
"Securities intermediary". Section 8-102(a)(14)
"Security agreement". Section 9-105(1)(l)
"Security interest". Section 1-201(37)

4-8-510. Rights of purchaser of security entitlement from entitlement holder. (a) In a case not covered by the priority rules in article 9 of this title or the rules stated in subsection (c) of this section, an action based on an adverse claim to a financial asset or security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim, and obtains control.

(b) If an adverse claim could not have been asserted against an entitlement holder under section 4-8-502, the adverse claim cannot be asserted against a person who purchases a security entitlement, or an interest therein, from the entitlement holder.

(c) In a case not covered by the priority rules in article 9 of this title, a purchaser for

value of a security entitlement, or an interest therein, who obtains control has priority over a purchaser of a security entitlement, or an interest therein, who does not obtain control. Except as otherwise provided in subsection (d) of this section, purchasers who have control rank according to priority in time of:

(1) The purchaser's becoming the person for whom the securities account, in which the security entitlement is carried, is maintained, if the purchaser obtained control under section 4-8-106 (d) (1);

(2) The securities intermediary's agreement to comply with the purchaser's entitlement orders with respect to security entitlements carried or to be carried in the securities account in which the security entitlement is carried, if the purchaser obtained control under section 4-8-106 (d) (2); or

(3) If the purchaser obtained control through another person under section 4-8-106 (d) (3), the time on which priority would be based under this subsection (c) if the other person were the secured party.

(d) A securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities intermediary.

Source: L. 96: Entire article R&RE, p. 232, § 2, effective July 1. **L. 2001:** Entire section amended, p. 1443, § 35, effective July 1.

OFFICIAL COMMENT

1. This section specifies certain rules concerning the rights of persons who purchase interests in security entitlements from entitlement holders. The rules of this section are provided to take account of cases where the purchaser's rights are derivative from the rights of another person who is and continues to be the entitlement holder.

2. Subsection (a) provides that no adverse claim can be asserted against a purchaser of an interest in a security entitlement if the purchaser gives value, obtains control, and does not have notice of the adverse claim. The primary purpose of this rule is to give adverse claim protection to persons who take security interests in security entitlements and obtain control, but do not themselves become entitlement holders.

The following examples illustrate subsection (a):

Example 1. X steals a certificated bearer bond from Owner. X delivers the certificate to Able & Co. for credit to X's securities account. Later, X borrows from Bank and grants bank a security interest in the security entitlement. Bank obtains control under Section 8-106(d)(2) by virtue of an agreement in which Able agrees to comply with entitlement orders originated by Bank. X absconds.

Example 2. Same facts as in Example 1, except that Bank does not obtain a control agreement. Instead, Bank perfects by filing a financing statement.

In both of these examples, when X deposited the bonds X acquired a security entitlement under Section 8-501. Under other law, Owner may be able to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that X misappropriated. X granted a security interest in that entitlement to Bank. Bank was a purchaser of an interest in the security entitlement from X. In Example 1, although Bank was not a person who acquired a security entitlement from the intermediary, Bank did obtain control. If Bank did not have notice of Owner's claim, Section 8-510(a) precludes Owner from asserting an adverse claim against Bank. In Example 2, Bank had a perfected security interest, but did not obtain control. Accordingly, Section 8-510(a) does not preclude Owner from asserting its adverse claim against Bank.

3. Subsection (b) applies to the indirect holding system a limited version of the "shelter principle." The following example illustrates the relatively limited class of cases for which it may be needed:

Example 3. Thief steals a certificated bearer bond from Owner. Thief delivers the certificate to Able & Co. for credit to Thief's securities account. Able forwards the certificate to a clearing corporation for credit to Able's account. Later Thief instructs Able to sell the positions in the bonds. Able sells to Baker & Co., acting as broker for Buyer. The trade is settled by book-entries in the accounts of Able and Baker at the clearing corporation, and in the accounts of Thief and Buyer at Able and Baker respectively. Owner may be able to reconstruct the trade records to show that settlement occurred in such fashion that the "same bonds" that were carried in Thief's account at Able are traceable into Buyer's account at Baker. Buyer later decides to donate the bonds to Alma Mater University and executes an assignment of its rights as entitlement holder to Alma Mater.

Buyer had a position in the bonds, which Buyer held in the form of a security entitlement

against Baker. Buyer then made a gift of the position to Alma Mater. Although Alma Mater is a purchaser, Section 1-201(33), it did not give value. Thus, Alma Mater is a person who purchased a security entitlement, or an interest therein, from an entitlement holder (Buyer). Buyer was protected against Owner's adverse claim by the Section 8-502 rule. Thus, by virtue of Section 8-510(b), Owner is also precluded from asserting an adverse claim against Alma Mater.

4. Subsection (c) specifies a priority rule for cases where an entitlement holder transfers conflicting interests in the same security entitlement to different purchasers. It follows the same principle as the Article 9 priority rule for investment property, that is, control trumps non-control. Indeed, the most significant category of conflicting "purchasers" may be secured parties. Priority questions for security interests, however, are governed by the rules in Article 9. Subsection (c) applies only to cases not covered by the Article 9 rules. It is intended primarily for disputes over conflicting claims arising out of repurchase agreement transactions that are not covered by the other rules set out in Articles 8 and 9.

The following example illustrates subsection (c):

Example 4. Dealer holds securities through an account at Alpha Bank. Alpha Bank in turns holds through a clearing corporation account. Dealer transfers securities to RP1 in a "hold in custody" repo transaction. Dealer then transfers the same securities to RP2 in another repo transaction. The repo to RP2 is implemented by transferring the securities from Dealer's regular account at Alpha Bank to a special account maintained by Alpha Bank for Dealer and RP2. The agreement among Dealer, RP2, and Alpha Bank provides that Dealer can make substitutions for the securities but RP2 can direct Alpha Bank to sell any securities held in the special account. Dealer becomes insolvent. RP1 claims a prior interest in the securities transferred to RP2.

In this example Dealer remained the entitlement holder but agreed that RP2 could initiate entitlement orders to Dealer's security intermediary, Alpha Bank. If RP2 had become the entitlement holder, the adverse claim rule of Section 8-502 would apply. Even if RP2 does not become the entitlement holder, the arrangement among Dealer, Alpha Bank, and RP2 does suffice to give RP2 control. Thus, under Section 8-510(c), RP2 has priority over RP1, because RP2 is a purchaser who obtained control, and RP1 is a purchaser who did not obtain control. The same result could be reached under Section 8-510(a) which provides that RP1's earlier in time interest cannot be asserted as an adverse claim against RP2. The same result would follow under the Article 9 priority rules if the interests of RP1 and RP2 are characterized as "security interests," see Section 9-115(5)(a). The main point of the rules of Section 8-510(c) is to ensure that there will be clear rules to cover the conflicting claims of RP1 and RP2 without characterizing their interests as Article 9 security interests.

The priority rules in Article 9 for conflicting security interests also include a default rule of pro rata treatment for cases where multiple secured parties have obtained control but omitted to specify their respective rights by agreement. See Section 9-115(5)(b) and Comment 6 to Section 9-115. Because the purchaser priority rule in Section 8-510(c) is intended to track the Article 9 priority rules, it too has a pro rata rule for cases where multiple non-secured party purchasers have obtained control but omitted to specify their respective rights by agreement.

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1)
"Control". Section 8-106
"Entitlement holder". Section 8-102(a)(7)
"Notice of adverse claim". Section 8-105
"Purchase". Section 1-201(32)
"Purchaser". Sections 1-201(33) & 8-116
"Securities intermediary". Section 8-102(a)(14)
"Security entitlement". Section 8-102(a)(17)
"Value". Sections 1-201(44) & 8-116

4-8-511. Priority among security interests and entitlement holders. (a) Except as otherwise provided in subsections (b) and (c) of this section, if a securities intermediary does not have sufficient interests in a particular financial asset to satisfy both its obligations to entitlement holders who have security entitlements to that financial asset and its obligation to a creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.

(b) A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.

(c) If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial

asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders.

Source: L. 96: Entire article R&RE, p. 232, § 2, effective July 1.

OFFICIAL COMMENT

1. This section sets out priority rules for circumstances in which a securities intermediary fails leaving an insufficient quantity of securities or other financial assets to satisfy the claims of its entitlement holders and the claims of creditors to whom it has granted security interests in financial assets held by it. Subsection (a) provides that entitlement holders' claims have priority except as otherwise provided in subsection (b), and subsection (b) provides that the secured creditor's claim has priority if the secured creditor obtains control, as defined in Section 8-106. The following examples illustrate the operation of these rules.

Example 1. Able & Co., a broker, borrows from Alpha Bank and grants Alpha Bank a security interest pursuant to a written agreement which identifies certain securities that are to be collateral for the loan, either specifically or by category. Able holds these securities in a clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Alpha Bank's security interest in the security entitlements that Able holds through the clearing corporation account may be perfected under the automatic perfection rule of Section 9-115(4)(c), but Alpha Bank did not obtain control under Section 8-106. Thus, under Section 8-511(a) the entitlement holders' claims have priority over Alpha Bank's claim.

Example 2. Able & Co., a broker, borrows from Beta Bank and grants Beta Bank a security interest in securities that Able holds in a clearing corporation account. Pursuant to the security agreement, the securities are debited from Alpha's account and credited to Beta's account in the clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Although the transaction between Able and Beta took the form of an outright transfer on the clearing corporation's books, as between Able and Beta, Able remains the owner and Beta has a security interest. In that respect the situation is no different than if Able had delivered bearer bonds to Beta in pledge to secure a loan. Beta's security interest is perfected, and Beta obtained control. See Sections 8-106 and 9-115. Under Section 8-511(b), Beta Bank's security interest has priority over claims of Able's customers.

The result in Example 2 is an application to this particular setting of the general principle expressed in Section 8-503, and explained in the Comments thereto, that the entitlement holders of a securities intermediary cannot assert rights against third parties to whom the intermediary has wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the transferor's wrongdoing. Under subsection (b) the claim of a secured creditor of a securities intermediary has priority over the claims of entitlement holders if the secured creditor has obtained control. If, however, the secured creditor acted in collusion with the intermediary in violating the intermediary's obligation to its entitlement holders, then under Section 8-503(e), the entitlement holders, through their representative in insolvency proceedings, could recover the interest from the secured creditor, that is, set aside the security interest.

2. The risk that investors who hold through an intermediary will suffer a loss as a result of a wrongful pledge by the intermediary is no different than the risk that the intermediary might fail and not have the securities that it was supposed to be holding on behalf of its customers, either because the securities were never acquired by the intermediary or because the intermediary wrongfully sold securities that should have been kept to satisfy customers' claims. Investors are protected against that risk by the regulatory regimes under which securities intermediaries operate. Intermediaries are required to maintain custody, through clearing corporation accounts or in other approved locations, of their customers' securities and are prohibited from using customers' securities in their own business activities. Securities firms who are carrying both customer and proprietary positions are not permitted to grant blanket liens to lenders covering all securities which they hold, for their own account or for their customers. Rather, securities firms designate specifically which positions they are pledging. Under SEC Rules 8c-1 and 15c2-1, customers' securities can be pledged only to fund loans to customers, and only with the consent of the customers. Customers' securities cannot be pledged for loans for the firm's proprietary business; only proprietary positions can be pledged for proprietary loans. SEC Rule 15c3-3 implements these prohibitions

in a fashion tailored to modern securities firm accounting systems by requiring brokers to maintain a sufficient inventory of securities, free from any liens, to satisfy the claims of all of their customers for fully paid and excess margin securities. Revised Article 8 mirrors that requirement, specifying in Section 8-504 that a securities intermediary must maintain a sufficient quantity of investment property to satisfy all security entitlements, and may not grant security interests in the positions it is required to hold for customers, except as authorized by the customers.

If a failed brokerage has violated the customer protection regulations and does not have sufficient securities to satisfy customers' claims, its customers are protected against loss from a shortfall by the Securities Investor Protection Act ("SIPA"). Securities firms required to register as brokers or dealers are also required to become members of the Securities Investor Protection Corporation ("SIPC"), which provides their customers with protection somewhat similar to that provided by FDIC and other deposit insurance programs for bank depositors. When a member firm fails, SIPC is authorized to initiate a liquidation proceeding under the provisions of SIPA. If the assets of the securities firm are insufficient to satisfy all customer claims, SIPA makes contributions to the estate from a fund financed by assessments on its members to protect customers against losses up to $500,000 for cash and securities held at member firms.

Article 8 is premised on the view that the important policy of protecting investors against the risk of wrongful conduct by their intermediaries is sufficiently treated by other law.

3. Subsection (c) sets out a special rule for secured financing provided to enable clearing corporations to complete settlement. The reasons that secured financing arrangements are needed in such circumstances are explained in Comment 7 to Section 9-115. In order to permit clearing corporations to establish liquidity facilities where necessary to ensure completion of settlement, subsection (c) provides a priority for secured lenders to such clearing corporations. Subsection (c) does not turn on control because the clearing corporation may be the top tier securities intermediary for the securities pledged, so that there may be no practicable method for conferring control on the lender.

Definitional Cross References:

"Clearing corporation". Section 8-102(a)(5)
"Control". Section 8-106
"Entitlement holder". Section 8-102(a)(7)
"Financial asset". Section 8-102(a)(9)
"Securities intermediary". Section 8-102(a)(14)
"Security entitlement". Section 8-102(a)(17)
"Security interest". Section 1-201(37)
"Value". Sections 1-201(44) & 8-116

PART 6

TRANSITION PROVISIONS FOR REVISED ARTICLE 8

4-8-601. Effective date. This article takes effect on July 1, 1996.

Source: L. 96: Entire article R&RE, p. 233, § 2, effective July 1.

4-8-602. Repeals. (Reserved)

Source: L. 96: Entire article R&RE, p. 233, § 2, effective July 1.

4-8-603. Savings clause. (a) This article does not affect an action or proceeding commenced before this article takes effect.

(b) If a security interest in a security is perfected at the date this article takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this article, no further action is required to continue perfection. If a security interest in a security is perfected at the date this article takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this article, the security interest remains perfected for a period of four months after the effective date and continues perfected thereafter if appropriate action to perfect under this article is taken within that period. If a security interest is perfected at the date this article takes effect and the security interest can be perfected by filing under this article, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect.

Source: L. 96: Entire article R&RE, p. 233, § 2, effective July 1.

OFFICIAL COMMENT

The revision of Article 8 should present few significant transition problems. Although the revision involves significant changes in terminology and analysis, the substantive rules are, in large measure, based upon the current practices and are consistent with results that could be reached, albeit at times with some struggle, by proper interpretation of the rules of present law. Thus, the new rules can be applied, without significant dislocations, to transactions and events that occurred prior to enactment.

The enacting provisions should not, whether by applicability, transition, or savings clause language, attempt to provide that old Article 8 continues to apply to "transactions," "events," "rights," "duties," "liabilities," or the like that occurred or accrued before the effective date and that new Article 8 applies to those that occur or accrue after the effective date. The reason for revising Article 8 and corresponding provisions of Article 9 is the concern that the provisions of old Article 8 could be interpreted or misinterpreted to yield results that impede the safe and efficient operation of the national system for the clearance and settlement of securities transactions. Accordingly, it is not the case that any effort should be made to preserve the applicability of old Article 8 to transactions and events that occurred before the effective date.

Only two circumstances seem to warrant continued application of rules of old Article 8. First, to avoid disruption in the conduct of litigation, it may make sense to provide for continued application of the old Article 8 rules to lawsuits pending before the effective date. Second, there are some limited circumstances in which prior law permitted perfection of security interests by methods that are not provided for in the revised version. Section 8-313(1)(h) (1978) permitted perfection of security interests in securities held through intermediaries by notice to the intermediary. Under Revised Articles 8 and 9, security interests can be perfected in such cases by control, which requires the agreement of the intermediary, or by filing. It is likely that secured parties who relied strongly on such collateral under prior law did not simply send notices but obtained agreements from the intermediaries that would suffice for control under the new rules. However, it seems appropriate to include a provision that gives a secured creditor some opportunity after the effective date to perfect in this or any other case in which there is doubt whether the method of perfection used under prior law would be sufficient under the new version.

ARTICLE 9

Secured Transactions

Editor's note: (1) The numbering and sequencing of C.R.S. subsections do not necessarily correspond with the numbering and sequencing of subsections in the uniform act.

(2) This article was numbered as article 9 of chapter 155, C.R.S. 1963. The provisions of this article were repealed and reenacted in 2001, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 2001, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated. For a detailed comparison of this article, see the comparative tables located in the back of the index.

Law reviews: For article, "Lien and Security Interest Provision of AAPL Model Operating Agreement", see 13 Colo. Law. 1216 (1984); for a discussion of a Tenth Circuit decision dealing with secured transactions, see 66 Den. U. L. Rev. 795 (1989); for article, "Mastering The Maze of Secured Transactions - PART 1", see 21 Colo. Law. 2329 (1992); for article, "Remastering the Maze: Revisions to UCC Article 9 Filing Provisions", see 25 Colo. Law. 3 (June 1996); for article, "Introducing Revised Article 9 of the Uniform Commercial Code", see 30 Colo. Law. 9 (September 2001); for article, "Perfecting Security Interests in Intellectual Property", see 32 Colo. Law. 85 (April 2003).

PART 1

GENERAL PROVISIONS

PART 2

EFFECTIVENESS OF SECURITY AGREEMENT; ATTACHMENT OF SECURITY INTEREST; RIGHTS OF PARTIES TO SECURITY AGREEMENT

PART 3

PERFECTION AND PRIORITY

PART 4

RIGHTS OF THIRD PARTIES

PART 5

FILING

PART 6

DEFAULT

PART 7

TRANSITION

PART 8

TRANSITION PROVISIONS FOR 2010 AMENDMENTS

PART 1

GENERAL PROVISIONS

4-9-101. Short title. This article may be cited as the "Uniform Commercial Code - Secured Transactions".

Source: L. 2001: Entire article R&RE, p. 1313, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-101 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** This Article supersedes former Uniform Commercial Code (UCC) Article 9. As did its predecessor, it provides a comprehensive scheme for the regulation of security interests in personal property and fixtures. For the most part this Article follows the general approach and retains much of the terminology of former Article 9. In addition to describing many aspects of the operation and interpretation of this Article, these Comments explain the material changes that this Article makes to former Article 9. Former Article 9 superseded the wide variety of pre-UCC security devices. Unlike the Comments to former Article 9, however, these Comments dwell very little on the pre-UCC state of the law. For that reason, the Comments to former Article 9 will remain of substantial historical value and interest. They also will remain useful in understanding the background and general conceptual approach of this Article.

Citations to "Bankruptcy Code Section ___" in these Comments are to Title 11 of the United States Code as in effect on December 31, 1998. **Note:** The date "December 31, 1998." will be replaced with "July 1, 2010.", effective July 1, 2013.

2. **Background and History.** In 1990, the Permanent Editorial Board for the UCC with the support of its sponsors, The American Law Institute and the National Conference of Commissioners on Uniform State Laws, established a committee to study Article 9 of the UCC. The study committee issued its report as of December 1, 1992, recommending the creation of a drafting committee for the revision of Article 9 and also recommending numerous specific changes to Article 9. Organized in 1993, a drafting committee met fifteen times from 1993 to 1998. This Article was approved by its sponsors in 1998. [This Article was conformed to revised Article 1 in 2001 and to amendments to Article 7 in 2003. The sponsors approved amendments to selected sections of this Article in 2010.] **Note:** The bracketed language takes effect July 1, 2013.

3. **Reorganization and Renumbering; Captions; Style.** This Article reflects a substantial reorganization of former Article 9 and renumbering of most sections. New Part 4 deals with several aspects of third-party rights and duties that are unrelated to perfection and priority. Some of these were covered by Part 3 of former Article 9. Part 5 deals with filing (covered by former Part 4) and Part 6 deals with default and enforcement (covered by former Part 5). Appendix I contains conforming revisions to other articles of the UCC, and Appendix II contains model provisions for production-money priority.

This Article also includes headings for the subsections as an aid to readers. Unlike section captions, which are part of the UCC, see Section 1-109, subsection headings are not a part of the official text itself and have not been approved by the sponsors. Each jurisdiction in which this Article is introduced may consider whether to adopt the headings as a part of the statute and whether to adopt a provision clarifying the effect, if any, to be given to the headings. This Article also has been conformed to current style conventions. **Note:** "Section 1-109," in the second sentence will be replaced with "Section 1-107,", effective July 1, 2013.

4. **Summary of Revisions.** Following is a brief summary of some of the more significant

revisions of Article 9 that are included in [the 1998 revision of] this Article.

Note: The bracketed language takes effect July 1, 2013.

a. **Scope of Article 9.** This Article expands the scope of Article 9 in several respects.

Deposit accounts. Section 9-109 includes within this Article's scope deposit accounts as original collateral, except in consumer transactions. Former Article 9 dealt with deposit accounts only as proceeds of other collateral.

Sales of payment intangibles and promissory notes. Section 9-109 also includes within the scope of this Article most sales of "payment intangibles" (defined in Section 9-102 as general intangibles under which an account debtor's principal obligation is monetary) and "promissory notes" (also defined in Section 9-102). Former Article 9 included sales of accounts and chattel paper, but not sales of payment intangibles or promissory notes. In its inclusion of sales of payment intangibles and promissory notes, this Article continues the drafting convention found in former Article 9; it provides that the sale of accounts, chattel paper, payment intangibles, or promissory notes creates a "security interest." The definition of "account" in Section 9-102 also has been expanded to include various rights to payment that were general intangibles under former Article 9.

Health-care-insurance receivables. Section 9-109 narrows Article 9's exclusion of transfers of interests in insurance policies by carving out of the exclusion "health-care-insurance receivables" (defined in Section 9-102). A health-care-insurance receivable is included within the definition of "account" in Section 9-102.

Nonpossessory statutory agricultural liens. Section 9-109 also brings nonpossessory statutory agricultural liens within the scope of Article 9.

Consignments. Section 9-109 provides that "true" consignments bailments for the purpose of sale by the bailee are security interests covered by Article 9, with certain exceptions. See Section 9-102 (defining "consignment"). Currently, many consignments are subject to Article 9's filing requirements by operation of former Section 2-326.

Supporting obligations and property securing rights to payment. This Article also addresses explicitly (i) obligations, such as guaranties and letters of credit, that support payment or performance of collateral such as accounts, chattel paper, and payment intangibles, and (ii) any property (including real property) that secures a right to payment or performance that is subject to an Article 9 security interest. See Sections 9-203, 9-308.

Commercial tort claims. Section 9-109 expands the scope of Article 9 to include the assignment of commercial tort claims by narrowing the exclusion of tort claims generally. However, this Article continues to exclude tort claims for bodily injury and other non-business tort claims of a natural person. See Section 9-102 (defining "commercial tort claim").

Transfers by States and governmental units of States. Section 9-109 narrows the exclusion of transfers by States and their governmental units. It excludes only transfers covered by another statute (other than a statute generally applicable to security interests) to the extent the statute governs the creation, perfection, priority, or enforcement of security interests.

Nonassignable general intangibles, promissory notes, health-care-insurance receivables, and letter-of-credit rights. This Article enables a security interest to attach to letter-of- credit rights, health-care-insurance receivables, promissory notes, and general intangibles, including contracts, permits, licenses, and franchises, notwithstanding a contractual or statutory prohibition against or limitation on assignment. This Article explicitly protects third parties against any adverse effect of the creation or attempted enforcement of the security interest. See Sections 9-408, 9-409.

Subject to Sections 9-408 and 9-409 and two other exceptions (Sections 9-406, concerning accounts, chattel paper, and payment intangibles, and 9-407, concerning interests in leased goods), Section 9-401 establishes a baseline rule that the inclusion of transactions and collateral within the scope of Article 9 has no effect on non-Article 9 law dealing with the alienability or inalienability of property. For example, if a commercial tort claim is nonassignable under other applicable law, the fact that a security interest in the claim is within the scope of Article 9 does not override the other applicable law's effective prohibition of assignment.

b. **Duties of Secured Party.** This Article provides for expanded duties of secured parties.

Release of control. Section 9-208 imposes upon a secured party having control of a deposit account, investment property, or a letter-of-credit right the duty to release control when there is no secured obligation and no commitment to give value. Section 9-209 contains analogous provisions when an account debtor has been notified to pay a secured party.

Information. Section 9-210 expands a secured party's duties to provide the debtor with information concerning collateral and the obligations that it secures.

Default and enforcement. Part 6 also includes some additional duties of secured parties in connection with default and enforcement. See, e.g., Section 9-616 (duty to explain calculation of deficiency or surplus in a consumer-goods transaction).

c. **Choice of Law.** The choice-of-law rules for the law governing perfection, the effect of perfection or nonperfection, and priority are

found in Part 3, Subpart 1 (Sections 9-301 through 9-307). See also Section 9-316.

Where to file: Location of debtor. This Article changes the choice-of-law rule governing perfection (i.e., where to file) for most collateral to the law of the jurisdiction where the debtor is located. See Section 9-301. Under former Article 9, the jurisdiction of the debtor's location governed only perfection and priority of a security interest in accounts, general intangibles, mobile goods, and, for purposes of perfection by filing, chattel paper and investment property.

Determining debtor's location. As a baseline rule, Section 9-307 follows former Section 9-103, under which the location of the debtor is the debtor's place of business (or chief executive office, if the debtor has more than one place of business). Section 9-307 contains three major exceptions. First, a "registered organization," such as a corporation or limited liability company, is located in the State under whose law the debtor is organized, e.g., a corporate debtor's State of incorporation. Second, an individual debtor is located at his or her principal residence. Third, there are special rules for determining the location of the United States and registered organizations organized under the law of the United States.

Location of non-U.S. debtors. If, applying the foregoing rules, a debtor is located in a jurisdiction whose law does not require public notice as a condition of perfection of a nonpossessory security interest, the entity is deemed located in the District of Columbia. See Section 9-307. Thus, to the extent that this Article applies to non-U.S. debtors, perfection could be accomplished in many cases by a domestic filing.

Priority. For tangible collateral such as goods and instruments, Section 9-301 provides that the law applicable to priority and the effect of perfection or nonperfection will remain the law of the jurisdiction where the collateral is located, as under former Section 9-103 (but without the confusing "last event" test). For intangible collateral, such as accounts, the applicable law for priority will be that of the jurisdiction in which the debtor is located.

Possessory security interests; agricultural liens. Perfection, the effect of perfection or nonperfection, and priority of a possessory security interest or an agricultural lien are governed by the law of the jurisdiction where the collateral subject to the security interest or lien is located. See Sections 9-301, 9-302.

Goods covered by certificates of title; deposit accounts; letter-of-credit rights; investment property. This Article includes several refinements to the treatment of choice-of-law matters for goods covered by certificates of title. See Section 9-303. It also provides special choice-of-law rules, similar to those for investment property under current Articles 8 and 9, for deposit accounts (Section 9-304), investment property (Section 9-305), and letter-of-credit rights (Section 9-306).

Change in applicable law. Section 9-316 addresses perfection following a change in applicable law.

d. **Perfection.** The rules governing perfection of security interests and agricultural liens are found in Part 3, Subpart 2 (Sections 9-308 through 9-316).

Deposit accounts; letter-of-credit rights. With certain exceptions, this Article provides that a security interest in a deposit account or a letter-of-credit right may be perfected only by the secured party's acquiring "control" of the deposit account or letter-of-credit right. See Sections 9-312, 9-314. Under Section 9-104, a secured party has "control" of a deposit account when, with the consent of the debtor, the secured party obtains the depositary bank's agreement to act on the secured party's instructions (including when the secured party becomes the account holder) or when the secured party is itself the depositary bank. The control requirements are patterned on Section 8-106, which specifies the requirements for control of investment property. Under Section 9-107, "control" of a letter-of-credit right occurs when the issuer or nominated person consents to an assignment of proceeds under Section 5-114.

Electronic chattel paper. Section 9-102 includes a new defined term: "electronic chattel paper." Electronic chattel paper is a record or records consisting of information stored in an electronic medium (i.e., it is not written). Perfection of a security interest in electronic chattel paper may be by control or filing. See Sections 9-105 (*sui generis* definition of control of electronic chattel paper), 9-312 (perfection by filing), 9-314 (perfection by control).

Investment property. The perfection requirements for "investment property" (defined in Section 9-102), including perfection by control under Section 9-106, remain substantially unchanged. However, a new provision in Section 9-314 is designed to ensure that a secured party retains control in "repledge" transactions that are typical in the securities markets.

Instruments, agricultural liens, and commercial tort claims. This Article expands the types of collateral in which a security interest may be perfected by filing to include instruments. See Section 9-312. Agricultural liens and security interests in commercial tort claims also are perfected by filing, under this Article. See Sections 9-308, 9-310.

Sales of payment intangibles and promissory notes. Although former Article 9 covered the outright sale of accounts and chattel paper, sales of most other types of receivables also are financing transactions to which Article 9 should apply. Accordingly, Section 9-102 expands the definition of "account" to include many types of receivables (including "health-care-insurance

receivables," defined in Section 9-102) that former Article 9 classified as "general intangibles." It thereby subjects to Article 9's filing system sales of more types of receivables than did former Article 9. Certain sales of payment intangibles primarily bank loan participation transactions should not be subject to the Article 9 filing rules. These transactions fall in a residual category of collateral, "payment intangibles" (general intangibles under which the account debtor's principal obligation is monetary), the sale of which is exempt from the filing requirements of Article 9. See Sections 9-102, 9-109, 9-309 (perfection upon attachment). The perfection rules for sales of promissory notes are the same as those for sales of payment intangibles.

Possessory security interests. Several provisions of this Article address aspects of security interests involving a secured party or a third party who is in possession of the collateral. In particular, Section 9-313 resolves a number of uncertainties under former Section 9-305. It provides that a security interest in collateral in the possession of a third party is perfected when the third party acknowledges in an authenticated record that it holds for the secured party's benefit. Section 9-313 also provides that a third party need not so acknowledge and that its acknowledgment does not impose any duties on it, unless it otherwise agrees. A special rule in Section 9-313 provides that if a secured party already is in possession of collateral, its security interest remains perfected by possession if it delivers the collateral to a third party and the collateral is accompanied by instructions to hold it for the secured party or to redeliver it to the secured party. Section 9-313 also clarifies the limited circumstances under which a security interest in goods covered by a certificate of title may be perfected by the secured party's taking possession.

Automatic perfection. Section 9-309 lists various types of security interests as to which no public-notice step is required for perfection (e.g., purchase-money security interests in consumer goods other than automobiles). This automatic perfection also extends to a transfer of a health-care-insurance receivable to a health-care provider. Those transfers normally will be made by natural persons who receive health-care services; there is little value in requiring filing for perfection in that context. Automatic perfection also applies to security interests created by sales of payment intangibles and promissory notes. Section 9-308 provides that a perfected security interest in collateral supported by a "supporting obligation" (such as an account supported by a guaranty) also is a perfected security interest in the supporting obligation, and that a perfected security interest in an obligation secured by a security interest or lien on property (e.g., a real-property mortgage) also is a perfected security interest in the security interest or lien.

e. **Priority; Special Rules for Banks and Deposit Accounts.** The rules governing priority of security interests and agricultural liens are found in Part 3, Subpart 3 (Sections 9-317 through 9-342). This Article includes several new priority rules and some special rules relating to banks and deposit accounts (Sections 9-340 through 9-342).

Purchase-money security interests: General; consumer-goods transactions; inventory. Section 9-103 substantially rewrites the definition of purchase-money security interest (PMSI) (although the term is not formally "defined"). The substantive changes, however, apply only to non-consumer-goods transactions. (Consumer transactions and consumer-goods transactions are discussed below in Comment 4.j.) For non-consumer-goods transactions, Section 9-103 makes clear that a security interest in collateral may be (to some extent) both a PMSI as well as a non-PMSI, in accord with the "dual status" rule applied by some courts under former Article 9 (thereby rejecting the "transformation" rule). The definition provides an even broader conception of a PMSI in inventory, yielding a result that accords with private agreements entered into in response to the uncertainty under former Article 9. It also treats consignments as purchase-money security interests in inventory. Section 9-324 revises the PMSI priority rules, but for the most part without material change in substance. Section 9-324 also clarifies the priority rules for competing PMSIs in the same collateral.

Purchase-money security interests in livestock; agricultural liens. Section 9-324 provides a special PMSI priority, similar to the inventory PMSI priority rule, for livestock. Section 9-322 (which contains the baseline first-to-file-or-perfect priority rule) also recognizes special non-Article 9 priority rules for agricultural liens, which can override the baseline first-in-time rule.

Purchase-money security interests in software. Section 9-324 contains a new priority rule for a software purchase-money security interest. (Section 9-102 includes a definition of "software.") Under Section 9-103, a software PMSI includes a PMSI in software that is used in goods that are also subject to a PMSI. (Note also that the definition of "chattel paper" has been expanded to include records that evidence a monetary obligation and a security interest in specific goods and software used in the goods.)

Investment property. The priority rules for investment property are substantially similar to the priority rules found in former Section 9-115, which was added in conjunction with the 1994 revisions to UCC Article 8. Under Section 9-328, if a secured party has control of investment property (Sections 8-106, 9-106), its secu-

rity interest is senior to a security interest perfected in another manner (e.g., by filing). Also under Section 9-328, security interests perfected by control generally rank according to the time that control is obtained or, in the case of a security entitlement or a commodity contract carried in a commodity account, the time when the control arrangement is entered into. This is a change from former Section 9-115, under which the security interests ranked equally. However, as between a securities intermediary's security interest in a security entitlement that it maintains for the debtor and a security interest held by another secured party, the securities intermediary's security interest is senior.

Deposit accounts. This Article's priority rules applicable to deposit accounts are found in Section 9-327. They are patterned on and are similar to those for investment property in former Section 9-115 and Section 9-328 of this Article. Under Section 9-327, if a secured party has control of a deposit account, its security interest is senior to a security interest perfected in another manner (i.e., as cash proceeds). Also under Section 9-327, security interests perfected by control rank according to the time that control is obtained, but as between a depositary bank's security interest and one held by another secured party, the depositary bank's security interest is senior. A corresponding rule in Section 9-340 makes a depositary bank's right of set-off generally senior to a security interest held by another secured party. However, if the other secured party becomes the depositary bank's customer with respect to the deposit account, then its security interest is senior to the depositary bank's security interest and right of set-off. Sections 9-327, 9-340.

Letter-of-credit rights. The priority rules for security interests in letter-of-credit rights are found in Section 9-329. They are somewhat analogous to those for deposit accounts. A security interest perfected by control has priority over one perfected in another manner (i.e., as a supporting obligation for the collateral in which a security interest is perfected). Security interests in a letter-of- credit right perfected by control rank according to the time that control is obtained. However, the rights of a transferee beneficiary or a nominated person are independent and superior to the extent provided in Section 5-114. See Section 9-109(c)(4).

Chattel paper and instruments. Section 9-330 is the successor to former Section 9-308. As under former Section 9-308, differing priority rules apply to purchasers of chattel paper who give new value and take possession (or, in the case of electronic chattel paper, obtain control) of the collateral depending on whether a conflicting security interest in the collateral is claimed merely as proceeds. The principal change relates to the role of knowledge and the effect of an indication of a previous assignment of the collateral. Section 9-330 also affords priority to purchasers of instruments who take possession in good faith and without knowledge that the purchase violates the rights of the competing secured party. In addition, to qualify for priority, purchasers of chattel paper, but not of instruments, must purchase in the ordinary course of business.

Proceeds. Section 9-322 contains new priority rules that clarify when a special priority of a security interest in collateral continues or does not continue with respect to proceeds of the collateral. Other refinements to the priority rules for proceeds are included in Sections 9-324 (purchase-money security interest priority) and 9-330 (priority of certain purchasers of chattel paper and instruments).

Miscellaneous priority provisions. This Article also includes (i) clarifications of selected good-faith-purchase and similar issues (Sections 9-317, 9-331); (ii) new priority rules to deal with the "double debtor" problem arising when a debtor creates a security interest in collateral acquired by the debtor subject to a security interest created by another person (Section 9-325); (iii) new priority rules to deal with the problems created when a change in corporate structure or the like results in a new entity that has become bound by the original debtor's after-acquired property agreement (Section 9-326); (iv) a provision enabling most transferees of funds from a deposit account or money to take free of a security interest (Section 9-332); (v) substantially rewritten and refined priority rules dealing with accessions and commingled goods (Sections 9-335, 9-336); (vi) revised priority rules for security interests in goods covered by a certificate of title (Section 9-337); and (vii) provisions designed to ensure that security interests in deposit accounts will not extend to most transferees of funds on deposit or payees from deposit accounts and will not otherwise "clog" the payments system (Sections 9-341, 9-342).

Model provisions relating to production-money security interests. Appendix II to this Article contains model definitions and priority rules relating to "production-money security interests" held by secured parties who give new value used in the production of crops. Because no consensus emerged on the wisdom of these provisions during the drafting process, the sponsors make no recommendation on whether these model provisions should be enacted.

f. **Proceeds.** Section 9-102 contains an expanded definition of "proceeds" of collateral which includes additional rights and property that arise out of collateral, such as distributions on account of collateral and claims arising out of the loss or nonconformity of, defects in, or damage to collateral. The term also includes collections on account of "supporting obligations," such as guarantees.

g. **Part 4: Additional Provisions Relating to Third-Party Rights.** New Part 4 contains several provisions relating to the relationships between certain third parties and the parties to secured transactions. It contains new Sections 9-401 (replacing former Section 9-311) (alienability of debtor's rights), 9-402 (replacing former Section 9-317) (secured party not obligated on debtor's contracts), 9-403 (replacing former Section 9-206) (agreement not to assert defenses against assignee), 9-404, 9-405, and 9-406 (replacing former Section 9-318) (rights acquired by assignee, modification of assigned contract, discharge of account debtor, restrictions on assignment of account, chattel paper, promissory note, or payment intangible ineffective), 9-407 (replacing some provisions of former Section 2A-303) (restrictions on creation or enforcement of security interest in leasehold interest or lessor's residual interest ineffective). It also contains new Sections 9-408 (restrictions on assignment of promissory notes, health-care-insurance receivables ineffective, and certain general intangibles ineffective) and 9-409 (restrictions on assignment of letter-of-credit rights ineffective), which are discussed above.

h. **Filing.** Part 5 (formerly Part 4) of Article 9 has been substantially rewritten to simplify the statutory text and to deal with numerous problems of interpretation and implementation that have arisen over the years.

Medium-neutrality. This Article is "medium-neutral"; that is, it makes clear that parties may file and otherwise communicate with a filing office by means of records communicated and stored in media other than on paper.

Identity of person who files a record; authorization. Part 5 is largely indifferent as to the person who effects a filing. Instead, it addresses whose authorization is necessary for a person to file a record with a filing office. The filing scheme does not contemplate that the identity of a "filer" will be a part of the searchable records. This approach is consistent with, and a necessary aspect of, eliminating signatures or other evidence of authorization from the system (except to the extent that filing offices may choose to employ authentication procedures in connection with electronic communications). As long as the appropriate person authorizes the filing, or, in the case of a termination statement, the debtor is entitled to the termination, it is largely insignificant whether the secured party or another person files any given record.

Section 9-509 collects in one place most of the rules that determine when a record may be filed. In general, the debtor's authorization is required for the filing of an initial financing statement or an amendment that adds collateral. With one further exception, a secured party of record's authorization is required for the filing of other amendments. The exception arises if a secured party has failed to provide a termination statement that is required because there is no outstanding secured obligation or commitment to give value. In that situation, a debtor is authorized to file a termination statement indicating that it has been filed by the debtor.

Financing statement formal requisites. The formal requisites for a financing statement are set out in Section 9-502. A financing statement must provide the name of the debtor and the secured party and an indication of the collateral that it covers. Sections 9-503 and 9-506 address the sufficiency of a name provided on a financing statement and clarify when a debtor's name is correct and when an incorrect name is insufficient. Section 9-504 addresses the indication of collateral covered. Under Section 9-504, a super-generic description (e.g.,"all assets" or "all personal property") in a financing statement is a sufficient indication of the collateral. (Note, however, that a super-generic description is inadequate for purposes of a security agreement. See Sections 9-108, 9-203.) To facilitate electronic filing, this Article does not require that the debtor's signature or other authorization appear on a financing statement. Instead, it prohibits the filing of unauthorized financing statements and imposes liability upon those who violate the prohibition. See Sections 9-509, 9-626.

Filing-office operations. Part 5 contains several provisions governing filing operations. First, it prohibits the filing office from rejecting an initial financing statement or other record for a reason other than one of the few that are specified. See Sections 9-520, 9-516. Second, the filing office is obliged to link all subsequent records (e.g., assignments, continuation statements, etc.) to the initial financing statement to which they relate. See Section 9-519. Third, the filing office may delete a financing statement and related records from the files no earlier than one year after lapse (lapse normally is five years after the filing date), and then only if a continuation statement has not been filed. See Sections 9-515, 9-519, 9-522. Thus, a financing statement and related records would be discovered by a search of the files even after the filing of a termination statement. This approach helps eliminate filing-office discretion and also eases problems associated with multiple secured parties and multiple partial assignments. Fourth, Part 5 mandates performance standards for filing offices. See Sections 9-519, 9-520, 9-523. Fifth, it provides for the promulgation of filing-office rules to deal with details best left out of the statute and requires the filing office to submit periodic reports. See Sections 9-526, 9-527.

[Correction of records:] Defaulting or missing secured parties and fraudulent filings. In some areas of the country, serious problems have arisen from fraudulent financing statements that are filed against public officials and other persons. This Article addresses the fraud problem by providing the opportunity for a

debtor to file a termination statement when a secured party wrongfully refuses or fails to provide a termination statement. See Section 9-509. This opportunity also addresses the problem of secured parties that simply disappear through mergers or liquidations. In addition, Section 9-518 affords a statutory method by which a debtor who believes that a filed record is inaccurate or was wrongfully filed may indicate that fact in the files [by filing a correction statement,] albeit without affecting the efficacy, if any, of the challenged record.
Note: The bracketed language will be deleted, effective July 1, 2013.

Extended period of effectiveness for certain financing statements. Section 9-515 contains an exception to the usual rule that financing statements are effective for five years unless a continuation statement is filed to continue the effectiveness for another five years. Under that section, an initial financing statement filed in connection with a "public-finance transaction" or a "manufactured-home transaction" (terms defined in Section 9-102) is effective for 30 years.

National form of financing statement and related forms. Section 9-521 provides for uniform, national written forms of financing statements and related written records that must be accepted by a filing office that accepts written records.

i. **Default and Enforcement.** Part 6 of Article 9 extensively revises former Part 5. Provisions relating to enforcement of consumer-goods transactions and consumer transactions are discussed in Comment 4.j.

Debtor, secondary obligor; waiver. Section 9-602 clarifies the identity of persons who have rights and persons to whom a secured party owes specified duties under Part 6. Under that section, the rights and duties are enjoyed by and run to the "debtor," defined in Section 9-102 to mean any person with a non-lien property interest in collateral, and to any "obligor." However, with one exception (Section 9-616, as it relates to a consumer obligor), the rights and duties concerned affect non-debtor obligors only if they are "secondary obligors." "Secondary obligor" is defined in Section 9-102 to include one who is secondarily obligated on the secured obligation, e.g., a guarantor, or one who has a right of recourse against the debtor or another obligor with respect to an obligation secured by collateral. However, under Section 9-628, the secured party is relieved from any duty or liability to any person unless the secured party knows that the person is a debtor or obligor. Resolving an issue on which courts disagreed under former Article 9, this Article generally prohibits waiver by a secondary obligor of its rights and a secured party's duties under Part 6. See Section 9-602. However, Section 9-624 permits a secondary obligor or debtor to waive the right to notification of disposition of collateral and, in a non-consumer transaction, the right to redeem collateral, if the secondary obligor or debtor agrees to do so after default.

Rights of collection and enforcement of collateral. Section 9-607 explains in greater detail than former 9-502 the rights of a secured party who seeks to collect or enforce collateral, including accounts, chattel paper, and payment intangibles. It also sets forth the enforcement rights of a depositary bank holding a security interest in a deposit account maintained with the depositary bank. Section 9-607 relates solely to the rights of a secured party vis-a-vis a debtor with respect to collections and enforcement. It does not affect the rights or duties of third parties, such as account debtors on collateral, which are addressed elsewhere (e.g., Section 9-406). Section 9-608 clarifies the manner in which proceeds of collection or enforcement are to be applied.

Disposition of collateral: Warranties of title. Section 9-610 imposes on a secured party who disposes of collateral the warranties of title, quiet possession, and the like that are otherwise applicable under other law. It also provides rules for the exclusion or modification of those warranties.

Disposition of collateral: Notification, application of proceeds, surplus and deficiency, other effects. Section 9-611 requires a secured party to give notification of a disposition of collateral to other secured parties and lienholders who have filed financing statements against the debtor covering the collateral. (That duty was eliminated by the 1972 revisions to Article 9.) However, that section relieves the secured party from that duty when the secured party undertakes a search of the records and a report of the results is unreasonably delayed. Section 9-613, which applies only to non-consumer transactions, specifies the contents of a sufficient notification of disposition and provides that a notification sent 10 days or more before the earliest time for disposition is sent within a reasonable time. Section 9-615 addresses the application of proceeds of disposition, the entitlement of a debtor to any surplus, and the liability of an obligor for any deficiency. Section 9-619 clarifies the effects of a disposition by a secured party, including the rights of transferees of the collateral.

Rights and duties of secondary obligor. Section 9-618 provides that a secondary obligor obtains the rights and assumes the duties of a secured party if the secondary obligor receives an assignment of a secured obligation, agrees to assume the secured party's rights and duties upon a transfer to it of collateral, or becomes subrogated to the rights of the secured party with respect to the collateral. The assumption, transfer, or subrogation is not a disposition of collateral under Section 9-610, but it does relieve the former secured party of further duties.

Former Section 9-504(5) did not address whether a secured party was relieved of its duties in this situation.

Transfer of record or legal title. Section 9-619 contains a new provision making clear that a transfer of record or legal title to a secured party is not of itself a disposition under Part 6. This rule applies regardless of the circumstances under which the transfer of title occurs.

Strict foreclosure. Section 9-620, unlike former Section 9-505, permits a secured party to accept collateral in partial satisfaction, as well as full satisfaction, of the obligations secured. This right of strict foreclosure extends to intangible as well as tangible property. Section 9-622 clarifies the effects of an acceptance of collateral on the rights of junior claimants. It rejects the approach taken by some courts deeming a secured party to have constructively retained collateral in satisfaction of the secured obligations in the case of a secured party's unreasonable delay in the disposition of collateral. Instead, unreasonable delay is relevant when determining whether a disposition under Section 9-610 is commercially reasonable.

Effect of noncompliance: "Rebuttable presumption" test. Section 9-626 adopts the "rebuttable presumption" test for the failure of a secured party to proceed in accordance with certain provisions of Part 6. (As discussed in Comment 4.j., the test does not necessarily apply to consumer transactions.) Under this approach, the deficiency claim of a noncomplying secured party is calculated by crediting the obligor with the greater of the actual net proceeds of a disposition and the amount of net proceeds that would have been realized if the disposition had been conducted in accordance with Part 6 (e.g., in a commercially reasonable manner). For non-consumer transactions, Section 9-626 rejects the "absolute bar" test that some courts have imposed; that approach bars a noncomplying secured party from recovering any deficiency, regardless of the loss (if any) the debtor suffered as a consequence of the noncompliance.

"Low-price" dispositions: Calculation of deficiency and surplus. Section 9-615(f) addresses the problem of procedurally regular dispositions that fetch a low price. Subsection (f) provides a special method for calculating a deficiency if the proceeds of a disposition of collateral to a secured party, a person related to the secured party, or a secondary obligor are "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought." ("Person related to" is defined in Section 9-102.) In these situations there is reason to suspect that there may be inadequate incentives to obtain a better price. Consequently, instead of calculating a deficiency (or surplus) based on the actual net proceeds, the deficiency (or surplus) would be calculated based on the proceeds that would have been received in a disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor.

j. **Consumer Goods, Consumer-Goods Transactions, and Consumer Transactions.** This Article (including the accompanying conforming revisions (see Appendix I)) includes several special rules for "consumer goods," "consumer transactions," and "consumer-goods transactions." Each term is defined in Section 9-102.

(i) Revised Sections 2-502 and 2-716 provide a buyer of consumer goods with enhanced rights to possession of the goods, thereby accelerating the opportunity to achieve "buyer in ordinary course of business" status under Section 1-201.

(ii) Section 9-103(e) (allocation of payments for determining extent of purchase- money status), (f) (purchase-money status not affected by cross-collateralization, refinancing, restructuring, or the like), and (g) (secured party has burden of establishing extent of purchase-money status) do not apply to consumer-goods transactions. Sections 9-103 also provides that the limitation of those provisions to transactions other than consumer-goods transactions leaves to the courts the proper rules for consumer-goods transactions and prohibits the courts from drawing inferences from that limitation.

(iii) Section 9-108 provides that in a consumer transaction a description of consumer goods, a security entitlement, securities account, or commodity account "only by [UCC-defined] type of collateral" is not a sufficient collateral description in a security agreement.

(iv) Sections 9-403 and 9-404 make effective the Federal Trade Commission's anti- holder-in-due-course rule (when applicable), 16 C.F.R. Part 433, even in the absence of the required legend.

(v) The 10-day safe-harbor for notification of a disposition provided by Section 9-612 does not apply in a consumer transaction.

(vi) Section 9-613 (contents and form of notice of disposition) does not apply to a consumer-goods transaction.

(vii) Section 9-614 contains special requirements for the contents of a notification of disposition and a safe-harbor, "plain English" form of notification, for consumer-goods transactions.

(viii) Section 9-616 requires a secured party in a consumer-goods transaction to provide a debtor with a notification of how it calculated a deficiency at the time it first undertakes to collect a deficiency.

(ix) Section 9-620 prohibits partial strict foreclosure with respect to consumer goods collateral and, unless the debtor agrees to waive the requirement in an authenticated record after default, in certain cases requires the secured party

to dispose of consumer goods collateral which has been repossessed.

(x) Section 9-626 ("rebuttable presumption" rule) does not apply to a consumer transaction. Section 9-626 also provides that its limitation to transactions other than consumer transactions leaves to the courts the proper rules for consumer transactions and prohibits the courts from drawing inferences from that limitation.

k. **Good Faith.** Section 9-102 contains a new definition of "good faith" that includes not only "honesty in fact" but also "the observance of reasonable commercial standards of fair dealing." The definition is similar to the ones adopted in connection with other, recently completed revisions of the UCC.

l. **Transition Provisions.** Part 7 (Sections 9-701 through 9-709) contains transition provisions. Transition from former Article 9 to this Article will be particularly challenging in view of its expanded scope, its modification of choice-of-law rules for perfection and priority, and its expansion of the methods of perfection.

m. **Conforming and Related Amendments to Other UCC Articles.** Appendix I contains several proposed revisions to the provisions and Comments of other UCC articles. For the most part the revisions are explained in the Comments to the proposed revisions. Cross-references in other UCC articles to sections of Article 9 also have been revised.

Article 1. Revised Section 1-201 contains revisions to the definitions of "buyer in ordinary course of business," "purchaser," and "security interest."

Articles 2 and 2A. Sections 2-210, 2-326, 2-502, 2-716, 2A-303, and 2A-307 have been revised to address the intersection between Articles 2 and 2A and Article 9.

Article 5. New Section 5-118 is patterned on Section 4-210. It provides for a security interest in documents presented under a letter of credit in favor of the issuer and a nominated person on the letter of credit.

Article 8. Revisions to Section 8-106, which deals with "control" of securities and security entitlements, conform it to Section 8-302, which deals with "delivery." Revisions to Section 8-110, which deals with a "securities intermediary's jurisdiction," conform it to the revised treatment of a "commodity intermediary's jurisdiction" in Section 9-305. Sections 8-301 and 8-302 have been revised for clarification. Section 8-510 has been revised to conform it to the revised priority rules of Section 9-328. Several Comments in Article 8 also have been revised.

ANNOTATION

Law reviews. For article, "Corporate Organization: A Manual of Colorado Procedure", see 1 Rocky Mt. L. Rev. 3 (1928). For note, "The Necessity for Recording Trust Receipts", see 4 Rocky Mt. L. Rev. 139 (1932). For note, "A Survey of the Colorado Torrens Act", see 5 Rocky Mt. L. Rev. 149 (1933). For note, "Leases of Personal Property as Security Transactions", see 5 Rocky Mt. L. Rev. 279 (1933). For note, "The Meaning of 'Third Persons' Under the Colorado Chattel Mortgage Act", see 6 Rocky Mt. L. Rev. 70 (1933). For note, "The Effect of the Extra-State Chattel Mortgage", see 20 Rocky Mt. L. Rev. 217 (1948). For article, "Security Transactions and the Conflict of Laws", see 37 Dicta 119 (1950). For article, "A Decade of Colorado Law: Conflict of Laws, Security, Contracts and Equity", see 23 Rocky Mt. L. Rev. 247 (1951). For article, "Installment Selling in Colorado and Needed Legislation", see 29 Dicta 81 (1952). For article, "The Perennial Problem of Security Priority and Recordation", see 24 Rocky Mt. L. Rev. 180 (1952). For article, "Enforcement of Security Interests in Colorado", see 25 Rocky Mt. L. Rev. 1 (1952). For article, "Discharge of Security Transactions", see 26 Rocky Mt. L. Rev. 115 (1954). For article, "Highlights of the 1955 Colorado Legislative Session — Security Transactions", see 28 Rocky Mt. L. Rev. 76 (1955). For note, "Validity of 'Myself' Notes and Deeds of Trust", see 30 Rocky Mt. L. Rev. 195 (1958). For article, "The New Colorado Chattel Mortgage Act", see 38 Dicta 231 (1961). For note, "The 1961 Colorado Chattel Mortgage Act", see 34 Rocky Mt. L. Rev. 222 (1962). For article, "Article 9 of the Uniform Commercial Code and Colorado Security Law", see 37 U. Colo. L. Rev. 11 (1964). For article, "Impact of the Uniform Commercial Code on Colorado Law", see 42 Den. L. Ctr. J. 67 (1965). For article, "U.C.C. Articles 9 and 10: Some Problems Solved and Some Problems Created", see 38 U. Colo. L. Rev. 99 (1965). For article, "Oil and Gas Financing Under the Uniform Commercial Code as Enacted in Colorado", see 43 Den. L.J. 129 (1966). For article, "Some Problems in Agricultural Lending Under UCC", see 39 U. Colo. L. Rev. 352 (1967). For note, "Creditor's Rights in Colorado and the Federal Tax Lien Act of 1966", see 40 U. Colo. L. Rev. 433 (1968).

Annotator's note. The following annotations include a case decided under this section as it existed prior to its 2001 repeal and reenactment.

Doctrine of unjust enrichment has not been displaced by the provisions of this code. Ninth Dist. Prod. Credit v. Ed Duggan, 821 P.2d 788 (Colo. 1991).

4-9-102. Definitions and index of definitions. (a) In this article:

(1) "Accession" means goods that are physically united with other goods in such a manner that the identity of the original goods is not lost.

(2) "Account", except as used in "account for", means a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a state, governmental unit of a state, or person licensed or authorized to operate the game by a state or governmental unit of a state. The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.

(3) "Account debtor" means a person obligated on an account, chattel paper, or general intangible. The term does not include persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper.

(4) "Accounting", except as used in "accounting for", means a record:

(A) Authenticated by a secured party;

(B) Indicating the aggregate unpaid secured obligations as of a date not more than thirty-five days earlier or thirty-five days later than the date of the record; and

(C) Identifying the components of the obligations in reasonable detail.

(5) "Agricultural lien" means an interest in farm products:

(A) Which secures payment or performance of an obligation for:

(i) Goods or services furnished in connection with a debtor's farming operation; or

(ii) Rent on real property leased by a debtor in connection with its farming operation;

(B) Which is created by statute in favor of a person that:

(i) In the ordinary course of its business furnished goods or services to a debtor in connection with a debtor's farming operation; or

(ii) Leased real property to a debtor in connection with the debtor's farming operation; and

(C) Whose effectiveness does not depend on the person's possession of the personal property.

(6) "As-extracted collateral" means:

(A) Oil, gas, minerals, or other substances of value that may be extracted from the earth that are subject to a security interest that:

(i) Is created by a debtor having an interest in the minerals or such other substances before extraction; and

(ii) Attaches to the minerals or such other substances as extracted; or

(B) Accounts arising out of the sale at the wellhead or minehead of oil, gas, minerals, or other substances of value that may be extracted from the earth in which the debtor had an interest before extraction.

(7) "Authenticate" means:

(A) To sign; or

(B) To execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record.

Editor's note: This version of subparagraph (B) is effective until July 1, 2013.

(B) With present intent to adopt or accept a record, to attach to or logically associate with the record an electronic sound, symbol, or process.

Editor's note: This version of subparagraph (B) is effective July 1, 2013.

(8) "Bank" means an organization that is engaged in the business of banking. The term includes savings banks, savings and loan associations, credit unions, and trust companies.

(8.5) "Business day" means any day other than Saturday, Sunday, or a state of Colorado or federal legal holiday.

(9) "Cash proceeds" means proceeds that are money, checks, deposit accounts, or the like.

(10) "Certificate of title" means a certificate of title with respect to which a statute provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral.

Editor's note: This version of paragraph (10) is effective until July 1, 2013.

(10) "Certificate of title" means a certificate of title with respect to which a statute provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. The term includes another record maintained as an alternative to a certificate of title by the governmental unit that issues certificates of title if a statute permits the security interest in question to be indicated on the record as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral.

Editor's note: This version of paragraph (10) is effective July 1, 2013.

(11) "Chattel paper" means a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this paragraph (11), "monetary obligation" means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does not include (i) charters or other contracts involving the use or hire of a vessel or (ii) records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper.

(12) "Collateral" means the property subject to a security interest or agricultural lien. The term includes:

(A) Proceeds to which a security interest attaches;

(B) Accounts, chattel paper, payment intangibles, and promissory notes that have been sold; and

(C) Goods that are the subject of a consignment.

(13) "Commercial tort claim" means a claim arising in tort with respect to which:

(A) The claimant is an organization; or

(B) The claimant is an individual and the claim:

(i) Arose in the course of the claimant's business or profession; and

(ii) Does not include damages arising out of personal injury to or the death of an individual.

(14) "Commodity account" means an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer.

(15) "Commodity contract" means a commodity futures contract, an option on a commodity futures contract, a commodity option, or another contract if the contract or option is:

(A) Traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to federal commodities laws; or

(B) Traded on a foreign commodity board of trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer.

(16) "Commodity customer" means a person for which a commodity intermediary carries a commodity contract on its books.

(17) "Commodity intermediary" means a person that:

(A) Is registered as a futures commission merchant under federal commodities law; or
(B) In the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to federal commodities law.
(18) "Communicate" means:
(A) To send a written or other tangible record;
(B) To transmit a record by any means agreed upon by the persons sending and receiving the record; or
(C) In the case of transmission of a record to or by a filing office, to transmit a record by any means prescribed by filing-office rule.
(19) "Consignee" means a merchant to which goods are delivered in a consignment.
(20) "Consignment" means a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and:
(A) The merchant:
(i) Deals in goods of that kind under a name other than the name of the person making delivery;
(ii) Is not an auctioneer; and
(iii) Is not generally known by its creditors to be substantially engaged in selling the goods of others;
(B) With respect to each delivery, the aggregate value of the goods is one thousand dollars or more at the time of delivery;
(C) The goods are not consumer goods immediately before delivery; and
(D) The transaction does not create a security interest that secures an obligation.
(21) "Consignor" means a person that delivers goods to a consignee in a consignment.
(22) "Consumer debtor" means a debtor in a consumer transaction.
(22.5) "Consumer deposit account" means a deposit account held in the name of one or more natural persons and used by him, her, or them primarily for personal, family, or household purposes.
(23) "Consumer goods" means goods that are used or bought for use primarily for personal, family, or household purposes.
(24) "Consumer-goods transaction" means a consumer transaction in which:
(A) An individual incurs an obligation primarily for personal, family, or household purposes; and
(B) A security interest in consumer goods secures the obligation.
(25) "Consumer obligor" means an obligor who is an individual and who incurred the obligation as part of a transaction entered into primarily for personal, family, or household purposes.
(26) "Consumer transaction" means a transaction in which (i) an individual incurs an obligation primarily for personal, family, or household purposes, (ii) a security interest secures the obligation, and (iii) the collateral is held or acquired primarily for personal, family, or household purposes. The term includes consumer-goods transactions.
(27) "Continuation statement" means an amendment of a financing statement which:
(A) Identifies, by its file number, the initial financing statement to which it relates; and
(B) Indicates that it is a continuation statement for, or that it is filed to continue the effectiveness of, the identified financing statement.
(28) "Debtor" means:
(A) A person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor;
(B) A seller of accounts, chattel paper, payment intangibles, or promissory notes; or
(C) A consignee.
(29) "Deposit account" means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.
(30) "Document" means a document of title or a receipt of the type described in section 4-7-201 (b).
(31) "Electronic chattel paper" means chattel paper evidenced by a record or records consisting of information stored in an electronic medium.

(32) "Encumbrance" means a right, other than an ownership interest, in real property. The term includes mortgages and other liens on real property.

(33) "Equipment" means goods other than inventory, farm products, or consumer goods.

(34) "Farm products" means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:

(A) Crops grown, growing, or to be grown, including:

(i) Crops produced on trees, vines, and bushes; and

(ii) Aquatic goods produced in aquacultural operations;

(B) Livestock, born or unborn, including aquatic goods produced in aquacultural operations;

(C) Supplies used or produced in a farming operation; or

(D) Products of crops or livestock in their unmanufactured states.

(35) "Farming operation" means raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation.

(36) "File number" means the number assigned to an initial financing statement pursuant to section 4-9-519 (a).

(37) "Filing office" means an office designated in section 4-9-501 as the place to file a financing statement.

(38) "Filing-office rule" means a rule adopted pursuant to section 4-9-526.

(39) "Financing statement" means a record or records composed of an initial financing statement and any filed record relating to the initial financing statement.

(40) "Fixture filing" means the filing of a financing statement covering goods that are or are to become fixtures and satisfying section 4-9-502 (a) and (b). The term includes the filing of a financing statement covering goods of a transmitting utility which are or are to become fixtures.

(41) "Fixtures" means goods that have become so related to particular real property that an interest in them arises under real property law.

(42) "General intangible" means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.

(43) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(44) "Goods" means all things that are movable when a security interest attaches. The term includes (i) fixtures, (ii) standing timber that is to be cut and removed under a conveyance or contract for sale, (iii) the unborn young of animals, (iv) crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes, and (v) manufactured homes. The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if (i) the program is associated with the goods in such a manner that it customarily is considered part of the goods, or (ii) by becoming the owner of the goods, a person acquires a right to use the program in connection with the goods. The term does not include a computer program embedded in goods that consist solely of the medium in which the program is embedded. The term also does not include accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money, or oil, gas, or other minerals before extraction.

(45) "Governmental unit" means a subdivision, agency, department, county, parish, municipality, or other unit of the government of the United States, a state, or a foreign country. The term includes an organization having a separate corporate existence if the organization is eligible to issue debt on which interest is exempt from income taxation under the laws of the United States.

(46) "Health-care-insurance receivable" means an interest in or claim under a policy of insurance that is a right to payment of a monetary obligation for health-care goods or services provided or to be provided.

(47) "Instrument" means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

(48) "Inventory" means goods, other than farm products, which:

(A) Are leased by a person as lessor;

(B) Are held by a person for sale or lease or to be furnished under a contract of service;

(C) Are furnished by a person under a contract of service; or

(D) Consist of raw materials, work in process, or materials used or consumed in a business.

(49) "Investment property" means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account.

(50) "Jurisdiction of organization", with respect to a registered organization, means the jurisdiction under whose law the organization is organized.

(51) "Letter-of-credit right" means a right to payment or performance under a letter of credit, whether or not the beneficiary has demanded or is at the time entitled to demand payment or performance. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit.

(52) "Lien creditor" means:

(A) A creditor that has acquired a lien on the property involved by attachment, levy, or the like;

(B) An assignee for benefit of creditors from the time of assignment;

(C) A trustee in bankruptcy from the date of the filing of the petition; or

(D) A receiver in equity from the time of appointment.

(53) "Manufactured home" means a structure, transportable in one or more sections, which, in the traveling mode, is eight body feet or more in width or forty body feet or more in length, or, when erected on site, is three hundred twenty or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air-conditioning, and electrical systems contained therein. The term includes any structure that meets all of the requirements of this paragraph (53) except the size requirements and with respect to which the manufacturer voluntarily files a certification required by the United States secretary of housing and urban development and complies with the standards established under Title 42 of the United States Code.

(54) "Manufactured-home transaction" means a secured transaction:

(A) That creates a purchase-money security interest in a manufactured home, other than a manufactured home held as inventory; or

(B) In which a manufactured home, other than a manufactured home held as inventory, is the primary collateral.

(55) "Mortgage" means a consensual interest in real property, including fixtures, which secures payment or performance of an obligation.

(56) "New debtor" means a person that becomes bound as debtor under section 4-9-203 (d) by a security agreement previously entered into by another person.

(57) "New value" means (i) money, (ii) money's worth in property, services, or new credit, or (iii) release by a transferee of an interest in property previously transferred to the transferee. The term does not include an obligation substituted for another obligation.

(58) "Noncash proceeds" means proceeds other than cash proceeds.

(59) "Obligor" means a person that, with respect to an obligation secured by a security interest in or an agricultural lien on the collateral, (i) owes payment or other performance of the obligation, (ii) has provided property other than the collateral to secure payment or other performance of the obligation, or (iii) is otherwise accountable in whole or in part for payment or other performance of the obligation. The term does not include issuers or nominated persons under a letter of credit.

(60) "Original debtor", except as used in section 4-9-310 (c), means a person that, as debtor, entered into a security agreement to which a new debtor has become bound under section 4-9-203 (d).

(61) "Payment intangible" means a general intangible under which the account debtor's principal obligation is a monetary obligation.

(62) "Person related to", with respect to an individual, means:

(A) The spouse of the individual;

(B) A brother, brother-in-law, sister, or sister-in-law of the individual;

(C) An ancestor or lineal descendant of the individual or the individual's spouse; or

(D) Any other relative, by blood or marriage, of the individual or the individual's spouse who shares the same home with the individual.

(63) "Person related to", with respect to an organization, means:

(A) A person directly or indirectly controlling, controlled by, or under common control with the organization;

(B) An officer or director of, or a person performing similar functions with respect to, the organization;

(C) An officer or director of, or a person performing similar functions with respect to, a person described in subparagraph (A) of this paragraph (63);

(D) The spouse of an individual described in subparagraph (A), (B), or (C) of this paragraph (63); or

(E) An individual who is related by blood or marriage to an individual described in subparagraph (A), (B), (C), or (D) of this paragraph (63) and shares the same home with the individual.

(64) "Proceeds", except as used in section 4-9-609 (b), means the following property:

(A) Whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;

(B) Whatever is collected on, or distributed on account of, collateral;

(C) Rights arising out of collateral;

(D) To the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or

(E) To the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

(65) "Promissory note" means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds.

Editor's note: Paragraph (65) is effective July 1, 2013.

(66) "Proposal" means a record authenticated by a secured party which includes the terms on which the secured party is willing to accept collateral in full or partial satisfaction of the obligation it secures pursuant to sections 4-9-620, 4-9-621, and 4-9-622.

Editor's note: Paragraph (66) is effective July 1, 2013.

(67) Reserved.

(68) "Promissory note" means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds.

Editor's note: This version of paragraph (68) is effective until July 1, 2013.

(68) "Public organic record" means a record that is available to the public for inspection and is:

(A) A record consisting of the record initially filed with or issued by a state or the United States to form or organize an organization and any record filed with or issued by the state or the United States that amends or restates the initial record;

(B) An organic record of a business trust consisting of the record initially filed with a state and any record filed with the state that amends or restates the initial record, if a statute of the state governing business trusts requires that the record be filed with the state; or

(C) A record consisting of legislation enacted by the legislature of a state or the congress of the United States that forms or organizes an organization, any record amending the legislation, and any record filed with or issued by the state or the United States that amends or restates the name of the organization.

Editor's note: This version of paragraph (68) is effective July 1, 2013.

(69) (A) "Proposal" means a record authenticated by a secured party which includes the terms on which the secured party is willing to accept collateral in full or partial satisfaction of the obligation it secures pursuant to sections 4-9-620, 4-9-621, and 4-9-622.

(B) This paragraph (69) is repealed, effective July 1, 2013.

(70) Reserved.

(71) "Pursuant to commitment", with respect to an advance made or other value given by a secured party, means pursuant to the secured party's obligation, whether or not a subsequent event of default or other event not within the secured party's control has relieved or may relieve the secured party from its obligation.

(72) "Record", except as used in "for record", "of record", "record or legal title", and "record owner", means information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form.

(73) "Registered organization" means an organization organized solely under the law of a single state or the United States and as to which the state or the United States must maintain a public record showing the organization to have been organized.

Editor's note: This version of paragraph (73) is effective until July 1, 2013.

(73) "Registered organization" means an organization formed or organized solely under the law of a single state or the United States by the filing of a public organic record with, the issuance of a public organic record by, or the enactment of legislation by the state or the United States. The term includes a business trust that is formed or organized under the law of a single state if a statute of the state governing business trusts requires that the business trust's organic record be filed with the state.

Editor's note: This version of paragraph (73) is effective July 1, 2013.

(74) "Secondary obligor" means an obligor to the extent that:

(A) The obligor's obligation is secondary; or

(B) The obligor has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor, or property of either.

(75) "Secured party" means:

(A) A person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding;

(B) A person that holds an agricultural lien;

(C) A consignor;

(D) A person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold;

(E) A trustee, indenture trustee, agent, collateral agent, or other representative in whose favor a security interest or agricultural lien is created or provided for; or

(F) A person that holds a security interest arising under section 4-2-401, 4-2-505, 4-2-711 (3), 4-2.5-508 (5), 4-4-210, or 4-5-117.5.

(76) "Security agreement" means an agreement that creates or provides for a security interest.

(77) "Send", in connection with a record or notification, means:

(A) To deposit in the mail, deliver for transmission, or transmit by any other usual means of communication, with postage or cost of transmission provided for, addressed to any address reasonable under the circumstances; or

(B) To cause the record or notification to be received within the time that it would have been received if properly sent under subparagraph (A) of this paragraph (77).

(78) "Software" means a computer program and any supporting information provided in connection with a transaction relating to the program. The term does not include a computer program that is included in the definition of goods.

(79) "State" means a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(80) "Supporting obligation" means a letter-of-credit right or secondary obligation that supports the payment or performance of an account, chattel paper, a document, a general intangible, an instrument, or investment property.

(81) "Tangible chattel paper" means chattel paper evidenced by a record or records consisting of information that is inscribed on a tangible medium.

(82) "Termination statement" means an amendment of a financing statement which:

(A) Identifies, by its file number, the initial financing statement to which it relates; and

(B) Indicates either that it is a termination statement or that the identified financing statement is no longer effective.

(83) "Transmitting utility" means a person primarily engaged in the business of:

(A) Operating a railroad, subway, street railway, or trolley bus;

(B) Transmitting communications electrically, electromagnetically, or by light;

(C) Transmitting goods by pipeline or sewer; or

(D) Transmitting or producing and transmitting electricity, steam, gas, or water.

(b) "Control" as provided in section 4-7-106 and the following definitions in other articles apply to this article:

"Applicant"	Section 4-5-102.
"Beneficiary"	Section 4-5-102.
"Broker"	Section 4-8-102.
"Certificated security"	Section 4-8-102.
"Check"	Section 4-3-104.
"Clearing corporation"	Section 4-8-102.
"Contract for sale"	Section 4-2-106.
"Customer"	Section 4-4-104.
"Entitlement holder"	Section 4-8-102.
"Financial asset"	Section 4-8-102.
"Holder in due course"	Section 4-3-302.
"Issuer" (with respect to a letter of credit or letter-of-credit right)	Section 4-5-102.
"Issuer" (with respect to a security)	Section 4-8-201.
"Issuer" (with respect to documents of title)	Section 4-7-102.
"Lease"	Section 4-2.5-103.
"Lease agreement"	Section 4-2.5-103.
"Lease contract"	Section 4-2.5-103.
"Leasehold interest"	Section 4-2.5-103.
"Lessee"	Section 4-2.5-103.
"Lessee in ordinary course of business"	Section 4-2.5-103.
"Lessor"	Section 4-2.5-103.
"Lessor's residual interest"	Section 4-2.5-103.
"Letter of credit"	Section 4-5-102.
"Merchant"	Section 4-2-104.
"Negotiable instrument"	Section 4-3-104.
"Nominated person"	Section 4-5-102.
"Note"	Section 4-3-104.
"Proceeds of a letter of credit"	Section 4-5-114.
"Prove"	Section 4-3-103.
"Sale"	Section 4-2-106.
"Securities account"	Section 4-8-501.
"Securities intermediary"	Section 4-8-102.
"Security"	Section 4-8-102.
"Security certificate"	Section 4-8-102.

"Security entitlement"	Section 4-8-102.
"Uncertificated security"	Section 4-8-102.

(c) Article 1 of this title contains general definitions and principles of construction and interpretation applicable throughout this article.

Source: L. 2001: Entire article R&RE, p. 1313, § 1, effective July 1. **L. 2002:** IP(a)(5) and (a)(46) amended, p. 937, § 1, effective August 7. **L. 2004:** (a)(77) amended, p. 1187, § 5, effective August 4. **L. 2006:** (a)(30) and (b) amended, p. 498, § 33, effective September 1. **L. 2007:** (b) amended, p. 376, § 30, effective August 3. **L. 2012:** (a)(7)(B), (a)(10), (a)(68), and (a)(73) amended, (a)(65) and (a)(66) added, and (a)(69) repealed, (HB 12-1262), ch. 170, p. 595, § 1, effective July 1, 2013.

Editor's note: (1) The provisions of this section are similar to provisions of several former sections as they existed prior to 2001. For a detailed comparison, see the comparative tables located in the back of the index.

(2) **Colorado legislative change:** Colorado substituted the phrase "Oil, gas, minerals, or other substances of value that may be extracted from the earth" for the phrase "Oil, gas, or other minerals" in subsection (a)(6) and added subsection (a)(8.5). Colorado added clause (ii) in subsection (a)(11), added subsection (a)(22.5), added the phrase "except as used in section 4-9-310 (c)," in subsection (a)(60), and added the phrase "except as used in section 4-9-609 (b)," in subsection (a)(64). Colorado reserved three definitional subsections, (a)(65) through (a)(67); all subsequent definitions are numbered correspondingly different from the uniform act. Colorado did not adopt the definition of a "public finance transaction".

(3) Subsections (65) and (66) are similar to subsections (68) and (69), respectively, as they existed prior to 2012.

OFFICIAL COMMENT

1. **Source.** All terms that are defined in Article 9 and used in more than one section are consolidated in this section. Note that the definition of "security interest" is found in Section 1-201, not in this Article, and has been revised. See Appendix I. Many of the definitions in this section are new; many others derive from those in former Section 9-105. The following Comments also indicate other sections of former Article 9 that defined (or explained) terms.

2. **Parties to Secured Transactions.**

a. "Debtor"; "Obligor"; "Secondary Obligor." Determining whether a person was a "debtor" under former Section 9-105(1)(d) required a close examination of the context in which the term was used. To reduce the need for this examination, this Article redefines "debtor" and adds new defined terms, "secondary obligor" and "obligor." In the context of Part 6 (default and enforcement), these definitions distinguish among three classes of persons: (i) those persons who may have a stake in the proper enforcement of a security interest by virtue of their non-lien property interest (typically, an ownership interest) in the collateral, (ii) those persons who may have a stake in the proper enforcement of the security interest because of their obligation to pay the secured debt, and (iii) those persons who have an obligation to pay the secured debt but have no stake in the proper enforcement of the security interest. Persons in the first class are debtors. Persons in the second class are secondary obligors if any portion of the obligation is secondary or if the obligor has a right of recourse against the debtor or another obligor with respect to an obligation secured by collateral. One must consult the law of suretyship to determine whether an obligation is secondary. The Restatement (3d), Suretyship and Guaranty 1 (1996), contains a useful explanation of the concept. Obligors in the third class are neither debtors nor secondary obligors. With one exception (Section 9-616, as it relates to a consumer obligor), the rights and duties provided by Part 6 affect non-debtor obligors only if they are "secondary obligors."

By including in the definition of "debtor" all persons with a property interest (other than a security interest in or other lien on collateral), the definition includes transferees of collateral, whether or not the secured party knows of the transfer or the transferee's identity. Exculpatory provisions in Part 6 protect the secured party in that circumstance. See Sections 9-605 and 9-628. The definition renders unnecessary former Section 9-112, which governed situations in which collateral was not owned by the debtor. The definition also includes a "consignee," as defined in this section, as well as a seller of accounts, chattel paper, payment intangibles, or promissory notes.

Secured parties and other lienholders are excluded from the definition of "debtor" because the interests of those parties normally derive from and encumber a debtor's interest. However, if in a *separate* secured transaction a se-

cured party grants, *as debtor*, a security interest in its own interest (i.e., its security interest and any obligation that it secures), the secured party is a debtor *in that transaction*. This typically occurs when a secured party with a security interest in specific goods assigns chattel paper.

Consider the following examples:

Example 1: Behnfeldt borrows money and grants a security interest in her Miata to secure the debt. Behnfeldt is a debtor and an obligor.

Example 2: Behnfeldt borrows money and grants a security interest in her Miata to secure the debt. Bruno co-signs a negotiable note as maker. As before, Behnfeldt is the debtor and an obligor. As an accommodation party (see Section 3-419), Bruno is a secondary obligor. Bruno has this status even if the note states that her obligation is a primary obligation and that she waives all suretyship defenses.

Example 3: Behnfeldt borrows money on an unsecured basis. Bruno co-signs the note and grants a security interest in her Honda to secure her obligation. Inasmuch as Behnfeldt does not have a property interest in the Honda, Behnfeldt is not a debtor. Having granted the security interest, Bruno is the debtor. Because Behnfeldt is a principal obligor, she is not a secondary obligor. Whatever the outcome of enforcement of the security interest against the Honda or Bruno's secondary obligation, Bruno will look to Behnfeldt for her losses. The enforcement will not affect Behnfeldt's aggregate obligations.

When the principal obligor (borrower) and the secondary obligor (surety) each has granted a security interest in different collateral, the status of each is determined by the collateral involved.

Example 4: Behnfeldt borrows money and grants a security interest in her Miata to secure the debt. Bruno co-signs the note and grants a security interest in her Honda to secure her obligation. When the secured party enforces the security interest in Behnfeldt's Miata, Behnfeldt is the debtor, and Bruno is a secondary obligor. When the secured party enforces the security interest in the Honda, Bruno is the "debtor." As in Example 3, Behnfeldt is an obligor, but not a secondary obligor.

b. **"Secured Party."** The secured party is the person in whose favor the security interest has been created, as determined by reference to the security agreement. This definition controls, among other things, which person has the duties and potential liability that Part 6 imposes upon a secured party. The definition of "secured party" also includes a "consignor," a person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold, and the holder of an agricultural lien.

The definition of "secured party" clarifies the status of various types of representatives. Consider, for example, a multi-bank facility under which Bank A, Bank B, and Bank C are lenders and Bank A serves as the collateral agent. If the security interest is granted to the banks, then they are the secured parties. If the security interest is granted to Bank A as collateral agent, then Bank A is the secured party.

c. **Other Parties.** A "consumer obligor" is defined as the obligor in a consumer transaction. Definitions of "new debtor" and "original debtor" are used in the special rules found in Sections 9-326 and 9-508.

3. **Definitions Relating to Creation of a Security Interest.**

a. **"Collateral."** As under former Section 9-105, "collateral" is the property subject to a security interest and includes accounts and chattel paper that have been sold. It has been expanded in this Article. The term now explicitly includes proceeds subject to a security interest. It also reflects the broadened scope of the Article. It includes property subject to an agricultural lien as well as payment intangibles and promissory notes that have been sold.

b. **"Security Agreement."** The definition of "security agreement" is substantially the same as under former Section 9-105 an agreement that creates or provides for a security interest. However, the term frequently was used colloquially in former Article 9 to refer to the document or writing that contained a debtor's security agreement. This Article eliminates that usage, reserving the term for the more precise meaning specified in the definition.

Whether an agreement creates a security interest depends not on whether the parties intend that the law *characterize* the transaction as a security interest but rather on whether the transaction falls within the definition of "security interest" in Section 1-201. Thus, an agreement that the parties characterize as a "lease" of goods may be a "security agreement," notwithstanding the parties' stated intention that the law treat the transaction as a lease and not as a secured transaction.

4. **Goods-Related Definitions.**

a. **"Goods"; "Consumer Goods"; "Equipment"; "Farm Products"; "Farming Operation"; "Inventory."** The definition of "goods" is substantially the same as the definition in former Section 9-105. This Article also retains the four mutually-exclusive "types" of collateral that consist of goods: "consumer goods," "equipment," "farm products," and "inventory." The revisions are primarily for clarification.

The classes of goods are mutually exclusive. For example, the same property cannot simultaneously be both equipment and inventory. In borderline cases a physician's car or a farmer's truck that might be either consumer goods or equipment the principal use to which the property is put is determinative. Goods can fall into different classes at different times. For example,

a radio may be inventory in the hands of a dealer and consumer goods in the hands of a consumer. As under former Article 9, goods are "equipment" if they do not fall into another category.

The definition of "consumer goods" follows former Section 9-109. The classification turns on whether the debtor uses or bought the goods for use "primarily for personal, family, or household purposes."

Goods are inventory if they are leased by a lessor or held by a person for sale or lease. The revised definition of "inventory" makes clear that the term includes goods leased by the debtor to others as well as goods held for lease. (The same result should have obtained under the former definition.) Goods to be furnished or furnished under a service contract, raw materials, and work in process also are inventory. Implicit in the definition is the criterion that the sales or leases are or will be in the ordinary course of business. For example, machinery used in manufacturing is equipment, not inventory, even though it is the policy of the debtor to sell machinery when it becomes obsolete or worn. Inventory also includes goods that are consumed in a business (e.g., fuel used in operations). In general, goods used in a business are equipment if they are fixed assets or have, as identifiable units, a relatively long period of use, but are inventory, even though not held for sale or lease, if they are used up or consumed in a short period of time in producing a product or providing a service.

Goods are "farm products" if the debtor is engaged in farming operations with respect to the goods. Animals in a herd of livestock are covered whether the debtor acquires them by purchase or as a result of natural increase. Products of crops or livestock remain farm products as long as they have not been subjected to a manufacturing process. The terms "crops" and "livestock" are not defined. The new definition of "farming operations" is for clarification only.

Crops, livestock, and their products cease to be "farm products" when the debtor ceases to be engaged in farming operations with respect to them. If, for example, they come into the possession of a marketing agency for sale or distribution or of a manufacturer or processor as raw materials, they become inventory. Products of crops or livestock, even though they remain in the possession of a person engaged in farming operations, lose their status as farm products if they are subjected to a manufacturing process. What is and what is not a manufacturing operation is not specified in this Article. At one end of the spectrum, some processes are so closely connected with farming such as pasteurizing milk or boiling sap to produce maple syrup or sugar that they would not constitute manufacturing. On the other hand an extensive canning operation would be manufacturing. Once farm products have been subjected to a manufacturing operation, they normally become inventory.

The revised definition of "farm products" clarifies the distinction between crops and standing timber and makes clear that aquatic goods produced in aquacultural operations may be either crops or livestock. Although aquatic goods that are vegetable in nature often would be crops and those that are animal would be livestock, this Article leaves the courts free to classify the goods on a case-by-case basis. See Section 9-324, Comment 11.

The definitions of "goods" and "software" are also mutually exclusive. Computer programs usually constitute "software," and, as such, are not "goods" as this Article uses the terms. However, under the circumstances specified in the definition of "goods," computer programs embedded in goods are part of the "goods" and are not "software."

b. **"Accession"; "Manufactured Home"; "Manufactured-Home Transaction."** Other specialized definitions of goods include "accession" (see the special priority and enforcement rules in Section 9-335), and "manufactured home" (see Section 9-515, permitting a financing statement in a "manufactured-home transaction" to be effective for 30 years). The definition of "manufactured home" borrows from the federal Manufactured Housing Act, 42 U.S.C. §§ 5401 *et seq.*, and is intended to have the same meaning.

c. **"As-Extracted Collateral."** Under this Article, oil, gas, and other minerals that have not been extracted from the ground are treated as real property, to which this Article does not apply. Upon extraction, minerals become personal property (goods) and eligible to be collateral under this Article. See the definition of "goods," which excludes "oil, gas, and other minerals before extraction." To take account of financing practices reflecting the shift from real to personal property, this Article contains special rules for perfecting security interests in minerals which attach upon extraction and in accounts resulting from the sale of minerals at the wellhead or minehead. See, e.g., Sections 9-301(4) (law governing perfection and priority); 9-501 (place of filing), 9-502 (contents of financing statement), 9-519 (indexing of records). The new term, "as-extracted collateral," refers to the minerals and related accounts to which the special rules apply. The term "at the wellhead" encompasses arrangements based on a sale of the produce at the moment that it issues from the ground and is measured, without technical distinctions as to whether title passes at the "Christmas tree" of a well, the far side of a gathering tank, or at some other point. The term "at . . . the minehead" is comparable.

The following examples explain the operation of these provisions.

Example 5: Debtor owns an interest in oil that is to be extracted. To secure Debtor's obligations to Lender, Debtor enters into an authenticated agreement granting Lender an interest in the oil. Although Lender may acquire an interest in the oil under real-property law, Lender does not acquire a security interest under this Article until the oil becomes personal property, i.e., until is extracted and becomes "goods" to which this Article applies. Because Debtor had an interest in the oil before extraction and Lender's security interest attached to the oil as extracted, the oil is "as-extracted collateral."

Example 6: Debtor owns an interest in oil that is to be extracted and contracts to sell the oil to Buyer at the wellhead. In an authenticated agreement, Debtor agrees to sell to Lender the right to payment from Buyer. This right to payment is an account that constitutes "as- extracted collateral." If Lender then resells the account to Financer, Financer acquires a security interest. However, inasmuch as the debtor-seller in that transaction, Lender, had no interest in the oil before extraction, Financer's collateral (the account it owns) is not "as- extracted collateral."

Example 7: Under the facts of Example 6, before extraction, Buyer grants a security interest in the oil to Bank. Although Bank's security interest attaches when the oil is extracted, Bank's security interest is not in "as-extracted collateral," inasmuch as its debtor, Buyer, did not have an interest in the oil before extraction.

5. **Receivables-related Definitions.**

a. **"Account"; "Health-Care-Insurance Receivable"; "As-Extracted Collateral."** The definition of "account" has been expanded and reformulated. It is no longer limited to rights to payment relating to goods or services. Many categories of rights to payment that were classified as general intangibles under former Article 9 are accounts under this Article. Thus, if they are sold, a financing statement must be filed to perfect the buyer's interest in them. [As used in the definition of "account," a right to payment "arising out of the use of a credit or charge card or information contained on or for use with the card" is the right of a card issuer to payment from its cardholder. A credit-card or charge-card transaction may give rise to other rights to payments; however, those other rights do not "arise out of the use" of the card or information contained on or for use with the card.] Among the types of property that are expressly excluded from the definition [of "account"] is "a right to payment for money or funds advanced or sold." As defined in Section 1-201, "money" is limited essentially to currency. As used in the exclusion from the definition of "account," however, "funds" is a broader concept (although the term is not defined). For example, when a bank-lender credits a borrower's deposit account for the amount of a loan, the bank's advance of funds is not a transaction giving rise to an account.

Note: The bracketed language takes effect July 1, 2013.

The definition of "health-care-insurance receivable" is new. It is a subset of the definition of "account." However, the rules generally applicable to account debtors on accounts do not apply to insurers obligated on health-care-insurance receivables. See Sections 9-404(e), 9-405(d), 9-406(i).

Note that certain accounts also are "as-extracted collateral." See Comment 4.c., Examples 6 and 7.

b. **"Chattel Paper"; "Electronic Chattel Paper"; "Tangible Chattel Paper."** "Chattel paper" consists of a monetary obligation together with a security interest in or a lease of specific goods if the obligation and security interest or lease are evidenced by "a record or records." The definition has been expanded from that found in former Article 9 to include records that evidence a monetary obligation and a *security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, or a lease of specific goods and license of software used in the goods. The expanded definition covers transactions in which the debtor's or lessee's monetary obligation includes amounts owed with respect to software used in the goods. The monetary obligation with respect to the software need not be owed under a license from the secured party or lessor, and the secured party or lessor need not be a party to the license transaction itself. Among the types of monetary obligations that are included in "chattel paper" are amounts that have been advanced by the secured party or lessor to enable the debtor or lessee to acquire or obtain financing for a license of the software used in the goods.** The definition also makes clear that rights to payment arising out of credit-card transactions are not chattel paper.

Charters of vessels are expressly excluded from the definition of chattel paper; they are accounts. The term "charter" as used in this section includes bareboat charters, time charters, successive voyage charters, contracts of affreightment, contracts of carriage, and all other arrangements for the use of vessels.

Under former Section 9-105, only if the evidence of an obligation consisted of "a writing or writings" could an obligation qualify as chattel paper. In this Article, traditional, written chattel paper is included in the definition of "tangible chattel paper." "Electronic chattel paper" is chattel paper that is stored in an electronic medium instead of in tangible form. The concept of an electronic medium should be construed liberally to include electrical, digital, magnetic, optical, electromagnetic, or any other current or similar emerging technologies.

[The definition of electronic chattel paper does not dictate that it be created in any particular fashion. For example, a record consisting of a tangible writing may be converted to electronic form (e.g., by creating electronic images of a signed writing). Or, records may be initially created and executed in electronic form (e.g., a lessee might authenticate an electronic record of a lease that is then stored in electronic form). In either case the resulting records are electronic chattel paper.] **Amendments in italics approved by the Permanent Editorial Board for Uniform Commercial Code October 20, 1999.*

Note: The bracketed language will be deleted, effective July 1, 2013.

c. **"Instrument"; "Promissory Note."** The definition of "instrument" includes a negotiable instrument. As under former Section 9-105, it also includes any other right to payment of a monetary obligation that is evidenced by a writing of a type that in ordinary course of business is transferred by delivery (and, if necessary, an indorsement or assignment). Except in the case of chattel paper, the fact that an instrument is secured by a security interest or encumbrance on property does not change the character of the instrument as such or convert the combination of the instrument and collateral into a separate classification of personal property. The definition makes clear that rights to payment arising out of credit-card transactions are not instruments. The definition of "promissory note" is new, necessitated by the inclusion of sales of promissory notes within the scope of Article 9. It explicitly excludes obligations arising out of "orders" to pay (e.g., checks) as opposed to "promises" to pay. See Section 3-104.

d. **"General Intangible"; "Payment Intangible."** "General intangible" is the residual category of personal property, including things in action, that is not included in the other defined types of collateral. Examples are various categories of intellectual property and the right to payment of a loan of funds that is not evidenced by chattel paper or an instrument. As used in the definition of "general intangible," "things in action" includes rights that arise under a license of intellectual property, including the right to exploit the intellectual property without liability for infringement. The definition has been revised to exclude commercial tort claims, deposit accounts, and letter-of-credit rights. Each of the three is a separate type of collateral. One important consequence of this exclusion is that tortfeasors (commercial tort claims), banks (deposit accounts), and persons obligated on letters of credit (letter-of-credit rights) are not "account debtors" having the rights and obligations set forth in Sections 9-404, 9-405, and 9-406. In particular, tortfeasors, banks, and persons obligated on letters of credit are not obligated to pay an assignee (secured party) upon receipt of the notification described in Section 9-404(a). See Comment 5.h. Another important consequence relates to the adequacy of the description in the security agreement. See Section 9-108.

"Payment intangible" is a subset of the definition of "general intangible." The sale of a payment intangible is subject to this Article. See Section 9-109(a)(3). Virtually any intangible right could give rise to a right to payment of money once one hypothesizes, for example, that the account debtor is in breach of its obligation. The term "payment intangible," however, embraces only those general intangibles "under which the account debtor's *principal* obligation is a monetary obligation." (Emphasis added.) [A debtor's right to payment from another person of amounts received by the other person on the debtor's behalf, including the right of a merchant in a credit-card, debit-card, prepaid-card, or other payment-card transaction to payment of amounts received by its bank from the card system in settlement of the transaction, is a "payment intangible." (In contrast, the right of a credit-card issuer to payment arising out of the use of a credit card is an "account.")]

Note: The bracketed language takes effect July 1, 2013.

In classifying intangible collateral, a court should begin by identifying the particular rights that have been assigned. The account debtor (promisor) under a particular contract may owe several types of monetary obligations as well as other, nonmonetary obligations. If the promisee's right to payment of money is assigned separately, the right is an account or payment intangible, depending on how the account debtor's obligation arose. When all the promisee's rights are assigned together, an account, a payment intangible, and a general intangible all may be involved, depending on the nature of the rights.

A right to the payment of money is frequently buttressed by ancillary covenants, such as covenants in a purchase agreement, note, or mortgage requiring insurance on the collateral or forbidding removal of the collateral, or covenants to preserve the creditworthiness of the promisor, such as covenants restricting dividends and the like. This Article does not treat these ancillary rights separately from the rights to payment to which they relate. For example, attachment and perfection of an assignment of a right to payment of a monetary obligation, whether it be an account or payment intangible, also carries these ancillary rights.

Note: This version of this paragraph is effective until July 1, 2013.

A right to the payment of money is frequently buttressed by ancillary rights, such as rights arising from covenants in a purchase agreement, note, or mortgage requiring insurance on the collateral or forbidding removal of the collateral, rights arising from covenants to preserve the creditworthiness of the promisor, and the

lessor's rights with respect to leased goods that arise upon the lessee's default (see Section 2A-523). This Article does not treat these ancillary rights separately from the rights to payment to which they relate. For example, attachment and perfection of an assignment of a right to payment of a monetary obligation, whether it be an account or payment intangible, also carries these ancillary rights. Thus, an assignment of the lessor's right to payment under a lease also transfers the lessor's rights with respect to the leased goods under Section 2A-523. If, taken together, the lessor's rights to payment and with respect to the leased goods are evidenced by chattel paper, then, contrary to *In re Commercial Money Center, Inc.*, 350 B.R. 465 (Bankr. App. 9th Cir. 2006), an assignment of the lessor's right to payment constitutes an assignment of the chattel paper. Although an agreement excluding the lessor's rights with respect to the leased goods from an assignment of the lessor's right to payment may be effective between the parties, the agreement does not affect the characterization of the collateral to the prejudice of creditors of, and purchasers from, the assignor.

Note: This version of this paragraph takes effect July 1, 2013.

Every "payment intangible" is also a "general intangible." Likewise, "software" is a "general intangible" for purposes of this Article. See Comment 25. Accordingly, except as otherwise provided, statutory provisions applicable to general intangibles apply to payment intangibles and software.

e. **"Letter-of-Credit Right."** The term "letter-of-credit right" embraces the rights to payment and performance under a letter of credit (defined in Section 5-102). However, it does not include a beneficiary's right to demand payment or performance. Transfer of those rights to a transferee beneficiary is governed by Article 5. See Sections 9-107, Comment 4, and 9-329, Comments 3 and 4.

f. **"Supporting Obligation."** This new term covers the most common types of credit enhancements suretyship obligations (including guarantees) and letter-of-credit rights that support one of the types of collateral specified in the definition. As explained in Comment 2.a., suretyship law determines whether an obligation is "secondary" for purposes of this definition. Section 9-109 generally excludes from this Article transfers of interests in insurance policies. However, the regulation of a secondary obligation as an insurance product does not necessarily mean that it is a "policy of insurance" for purposes of the exclusion in Section 9-109. Thus, this Article may cover a secondary obligation (as a supporting obligation), even if the obligation is issued by a regulated insurance company and the obligation is subject to regulation as an "insurance" product.

This Article contains rules explicitly governing attachment, perfection, and priority of security interests in supporting obligations. See Sections 9-203, 9-308, 9-310, and 9-322. These provisions reflect the principle that a supporting obligation is an incident of the collateral it supports.

Collections of or other distributions under a supporting obligation are "proceeds" of the supported collateral as well as "proceeds" of the supporting obligation itself. See Section 9-102 (defining "proceeds") and Comment 13.b. As such, the collections and distributions are subject to the priority rules applicable to proceeds generally. See Section 9-322. However, under the special rule governing security interests in a letter-of-credit right, a secured party's failure to obtain control (Section 9-107) of a letter-of-credit right supporting collateral may leave its security interest exposed to a priming interest of a party who does take control. See Section 9-329 (security interest in a letter-of-credit right perfected by control has priority over a conflicting security interest).

g. **"Commercial Tort Claim."** This term is new. A tort claim may serve as original collateral under this Article only if it is a "commercial tort claim." See Section 9-109(d). Although security interests in commercial tort claims are within its scope, this Article does not override other applicable law restricting the assignability of a tort claim. See Section 9-401. A security interest in a tort claim also may exist under this Article if the claim is proceeds of other collateral.

h. **"Account Debtor."** An "account debtor" is a person obligated on an account, chattel paper, or general intangible. The account debtor's obligation often is a monetary obligation; however, this is not always the case. For example, if a franchisee uses its rights under a franchise agreement (a general intangible) as collateral, then the franchisor is an "account debtor." As a general matter, Article 3, and not Article 9, governs obligations on negotiable instruments. Accordingly, the definition of "account debtor" excludes obligors on negotiable instruments constituting part of chattel paper. The principal effect of this change from the definition in former Article 9 is that the rules in Sections 9-403, 9-404, 9-405, and 9-406, dealing with the rights of an assignee and duties of an account debtor, do not apply to an assignment of chattel paper in which the obligation to pay is evidenced by a negotiable instrument. (Section 9-406(d), however, does apply to promissory notes, including negotiable promissory notes.) Rather, the assignee's rights are governed by Article 3. Similarly, the duties of an obligor on a nonnegotiable instrument are governed by non-Article 9 law unless the nonnegotiable instrument is a part of chattel paper, in which case the obligor is an account debtor.

i. **Receivables Under Government Entitlement Programs.** This Article does not contain a defined term that encompasses specifically rights to payment or performance under the many and varied government entitlement programs. Depending on the nature of a right under a program, it could be an account, a payment intangible, a general intangible other than a payment intangible, or another type of collateral. The right also might be proceeds of collateral (e.g., crops).

6. **Investment-Property-Related Definitions: "Commodity Account"; "Commodity Contract"; "Commodity Customer"; "Commodity Intermediary"; "Investment Property."** These definitions are substantially the same as the corresponding definitions in former Section 9-115. "Investment property" includes securities, both certificated and uncertificated, securities accounts, security entitlements, commodity accounts, and commodity contracts. The term investment property includes a "securities account" in order to facilitate transactions in which a debtor wishes to create a security interest in all of the investment positions held through a particular account rather than in particular positions carried in the account. Former Section 9-115 was added in conjunction with Revised Article 8 and contained a variety of rules applicable to security interests in investment property. These rules have been relocated to the appropriate sections of Article 9. See, e.g., Sections 9-203 (attachment), 9-314 (perfection by control), 9-328 (priority).

The terms "security," "security entitlement," and related terms are defined in Section 8-102, and the term "securities account" is defined in Section 8-501. The terms "commodity account," "commodity contract," "commodity customer," and "commodity intermediary" are defined in this section. Commodity contracts are not "securities" or "financial assets" under Article 8. See Section 8-103(f). Thus, the relationship between commodity intermediaries and commodity customers is not governed by the indirect-holding-system rules of Part 5 of Article 8. For securities, Article 9 contains rules on security interests, and Article 8 contains rules on the rights of transferees, including secured parties, on such matters as the rights of a transferee if the transfer was itself wrongful and gives rise to an adverse claim. For commodity contracts, Article 9 establishes rules on security interests, but questions of the sort dealt with in Article 8 for securities are left to other law.

The indirect-holding-system rules of Article 8 are sufficiently flexible to be applied to new developments in the securities and financial markets, where that is appropriate. Accordingly, the definition of "commodity contract" is narrowly drafted to ensure that it does not operate as an obstacle to the application of the Article 8 indirect-holding-system rules to new products. The term "commodity contract" covers those contracts that are traded on or subject to the rules of a designated contract market and foreign commodity contracts that are carried on the books of American commodity intermediaries. The effect of this definition is that the category of commodity contracts that are excluded from Article 8 but governed by Article 9 is essentially the same as the category of contracts that fall within the exclusive regulatory jurisdiction of the federal Commodity Futures Trading Commission.

Commodity contracts are different from securities or other financial assets. A person who enters into a commodity futures contract is not buying an asset having a certain value and holding it in anticipation of increase in value. Rather the person is entering into a contract to buy or sell a commodity at set price for delivery at a future time. That contract may become advantageous or disadvantageous as the price of the commodity fluctuates during the term of the contract. The rules of the commodity exchanges require that the contracts be marked to market on a daily basis; that is, the customer pays or receives any increment attributable to that day's price change. Because commodity customers may incur obligations on their contracts, they are required to provide collateral at the outset, known as "original margin," and may be required to provide additional amounts, known as "variation margin," during the term of the contract.

The most likely setting in which a person would want to take a security interest in a commodity contract is where a lender who is advancing funds to finance an inventory of a physical commodity requires the borrower to enter into a commodity contract as a hedge against the risk of decline in the value of the commodity. The lender will want to take a security interest in both the commodity itself and the hedging commodity contract. Typically, such arrangements are structured as security interests in the entire commodity account in which the borrower carries the hedging contracts, rather than in individual contracts.

One important effect of including commodity contracts and commodity accounts in Article 9 is to provide a clearer legal structure for the analysis of the rights of commodity clearing organizations against their participants and futures commission merchants against their customers. The rules and agreements of commodity clearing organizations generally provide that the clearing organization has the right to liquidate any participant's positions in order to satisfy obligations of the participant to the clearing corporation. Similarly, agreements between futures commission merchants and their customers generally provide that the futures commission merchant has the right to liquidate a customer's

positions in order to satisfy obligations of the customer to the futures commission merchant.

The main property that a commodity intermediary holds as collateral for the obligations that the commodity customer may incur under its commodity contracts is not other commodity contracts carried by the customer but the other property that the customer has posted as margin. Typically, this property will be securities. The commodity intermediary's security interest in such securities is governed by the rules of this Article on security interests in securities, not the rules on security interests in commodity contracts or commodity accounts.

Although there are significant analytic and regulatory differences between commodities and securities, the development of commodity contracts on financial products in the past few decades has resulted in a system in which the commodity markets and securities markets are closely linked. The rules on security interests in commodity contracts and commodity accounts provide a structure that may be essential in times of stress in the financial markets. Suppose, for example that a firm has a position in a securities market that is hedged by a position in a commodity market, so that payments that the firm is obligated to make with respect to the securities position will be covered by the receipt of funds from the commodity position. Depending upon the settlement cycles of the different markets, it is possible that the firm could find itself in a position where it is obligated to make the payment with respect to the securities position before it receives the matching funds from the commodity position. If cross-margining arrangements have not been developed between the two markets, the firm may need to borrow funds temporarily to make the earlier payment. The rules on security interests in investment property would facilitate the use of positions in one market as collateral for loans needed to cover obligations in the other market.

7. **Consumer-Related Definitions: "Consumer Debtor"; "Consumer Goods"; "Consumer-goods transaction"; "Consumer Obligor"; "Consumer Transaction."** The definition of "consumer goods" (discussed above) is substantially the same as the definition in former Section 9-109. The definitions of "consumer debtor," "consumer obligor," "consumer-goods transaction," and "consumer transaction" have been added in connection with various new (and old) consumer-related provisions and to designate certain provisions that are inapplicable in consumer transactions.

"Consumer-goods transaction" is a subset of "consumer transaction." Under each definition, both the obligation secured and the collateral must have a personal, family, or household purpose. However, "mixed" business and personal transactions also may be characterized as a consumer-goods transaction or consumer transaction. Subparagraph (A) of the definition of consumer-goods transactions and clause (i) of the definition of consumer transaction are primary purposes tests. Under these tests, it is necessary to determine the primary purpose of the obligation or obligations secured. Subparagraph (B) and clause (iii) of these definitions are satisfied if any of the collateral is consumer goods, in the case of a consumer-goods transaction, or "is held or acquired primarily for personal, family, or household purposes," in the case of a consumer transaction. The fact that some of the obligations secured or some of the collateral for the obligation does not satisfy the tests (e.g., some of the collateral is acquired for a business purpose) does not prevent a transaction from being a "consumer transaction" or "consumer-goods transaction."

8. **Filing-Related Definitions: "Continuation Statement"; "File Number"; "Filing Office"; "Filing-office Rule"; "Financing Statement"; "Fixture Filing"; "Manufactured-Home Transaction"; "New Debtor"; "Original Debtor"; "Public-Finance Transaction"; "Termination Statement"; "Transmitting Utility."** These definitions are used exclusively or primarily in the filing-related provisions in Part 5. Most are self-explanatory and are discussed in the Comments to Part 5. A financing statement filed in a manufactured-home transaction or a public-finance transaction may remain effective for 30 years instead of the 5 years applicable to other financing statements. See Section 9-515(b). The definitions relating to medium neutrality also are significant for the filing provisions. See Comment 9.

The definition of "transmitting utility" has been revised to embrace the business of transmitting communications generally to take account of new and future types of communications technology. The term designates a special class of debtors for whom separate filing rules are provided in Part 5, thereby obviating the many local fixture filings that would be necessary under the rules of Section 9-501 for a far-flung public-utility debtor. A transmitting utility will not necessarily be regulated by or operating as such in a jurisdiction where fixtures are located. For example, a utility might own transmission lines in a jurisdiction, although the utility generates no power and has no customers in the jurisdiction.

9. **Definitions Relating to Medium Neutrality.**

a. **"Record."** In many, but not all, instances, the term "record" replaces the term "writing" and "written." A "record" includes information that is in intangible form (e.g., electronically stored) as well as tangible form (e.g., written on paper). Given the rapid development and commercial adoption of modern communication and storage technologies, requirements that documents or communications be "written," "in

writing," or otherwise in tangible form do not necessarily reflect or aid commercial practices.

A "record" need not be permanent or indestructible, but the term does not include any oral or other communication that is not stored or preserved by any means. The information must be stored on paper or in some other medium. Information that has not been retained other than through human memory does not qualify as a record. Examples of current technologies commercially used to communicate or store information include, but are not limited to, magnetic media, optical discs, digital voice messaging systems, electronic mail, audio tapes, and photographic media, as well as paper. "Record" is an inclusive term that includes all of these methods of storing or communicating information. Any "writing" is a record. A record may be authenticated. See Comment 9.b. A record may be created without the knowledge or intent of a particular person.

Like the terms "written" or "in writing," the term "record" does not establish the purposes, permitted uses, or legal effect that a record may have under any particular provision of law. Whatever is filed in the Article 9 filing system, including financing statements, continuation statements, and termination statements, whether transmitted in tangible or intangible form, would fall within the definition. However, in some instances, statutes or filing-office rules may require that a paper record be filed. In such cases, even if this Article permits the filing of an electronic record, compliance with those statutes or rules is necessary. Similarly, a filer must comply with a statute or rule that requires a particular type of encoding or formatting for an electronic record.

This Article sometimes uses the terms "for record," "of record," "record or legal title," and "record owner." Some of these are terms traditionally used in real-property law. The definition of "record" in this Article now explicitly excepts these usages from the defined term. Also, this Article refers to a record that is filed or recorded in real-property recording systems to record a mortgage as a "record of a mortgage." This usage recognizes that the defined term "mortgage" means an interest in real property; it does not mean the record that evidences, or is filed or recorded with respect to, the mortgage.

b. **"Authenticate"; "Communicate"; "Send."** The terms "authenticate" and "authenticated" generally replace "sign" and "signed." "Authenticated" replaces and broadens the definition of "signed," in Section 1-201, to encompass authentication of all records, not just writings. (References to authentication of, e.g., an agreement, demand, or notification mean, of course, authentication of a record containing an agreement, demand, or notification.) The terms "communicate" and "send" also contemplate the possibility of communication by nonwritten media. These definitions include the act of transmitting both tangible and intangible records. The definition of "send" replaces, for purposes of this Article, the corresponding term in Section 1-201. The reference to "usual means of communication" in that definition contemplates an inquiry into the appropriateness of the method of transmission used in the particular circumstances involved.

10. **Scope-Related Definitions.**

a. **Expanded Scope of Article: "Agricultural Lien"; "Consignment"; "Payment Intangible"; "Promissory Note."** These new definitions reflect the expanded scope of Article 9, as provided in Section 9-109(a).

b. **Reduced Scope of Exclusions: "Governmental Unit"; "Health-Care- Insurance Receivable"; "Commercial Tort Claims."** These new definitions reflect the reduced scope of the exclusions, provided in Section 9-109(c) and (d), of transfers by governmental debtors and assignments of interests in insurance policies and commercial tort claims.

11. **Choice-of-Law-Related Definitions: "Certificate of Title"; "Governmental Unit"; "Jurisdiction of Organization"; [Public Organic Record";] "Registered Organization"; "State."** These new definitions reflect the changes in the law governing perfection and priority of security interests and agricultural liens provided in Part 3, Subpart 1.

Note: The bracketed language takes effect July 1, 2013.

[Statutes often require applicants for a certificate of title to identify all security interests on the application and require the issuing agency to indicate the identified security interests on the certificate. Some of these statutes provide that priority over the rights of a lien creditor (i.e., perfection of a security interest) in goods covered by the certificate occurs upon indication of the security interest on the certificate; that is, they provide for the indication of the security interest on the certificate as a "condition" of perfection. Other statutes contemplate that perfection is achieved upon the occurrence of another act, e.g., delivery of the application to the issuing agency, that "results" in the indication of the security interest on the certificate. A certificate governed by either type of statute can qualify as a "certificate of title" under this Article. The statute providing for the indication of a security interest need not expressly state the connection between the indication and perfection. For example, a certificate issued pursuant to a statute that requires applicants to identify security interests, requires the issuing agency to indicate the identified security interests on the certificate, but is silent concerning the legal consequences of the indication would be a "certificate of title" if, under a judicial interpretation of the statute, perfection of a security interest is a legal consequence of the indication. Likewise,

a certificate would be a "certificate of title" if another statute provides, expressly or as interpreted, the requisite connection between the indication and perfection.]

Note: The bracketed language takes effect July 1, 2013.

[The first sentence of the definition of "certificate of title" includes certificates consisting of tangible records, of electronic records, and of combinations of tangible and electronic records.]

Note: The bracketed language takes effect July 1, 2013.

[In many States, a certificate of title covering goods that are encumbered by a security interest is delivered to the secured party by the issuing authority. To eliminate the need for the issuance of a paper certificate under these circumstances, several States have revised their certificate-of-title statutes to permit or require a State agency to maintain an electronic record that evidences ownership of the goods and in which a security interest in the goods may be noted. The second sentence of the definition provides that such a record is a "certificate of title" if it is in fact maintained as an alternative to the issuance of a paper certificate of title, regardless of whether the certificate-of-title statute provides that the record is a certificate of title and even if the statute does not expressly state that the record is maintained instead of issuing a paper certificate.]

Note: The bracketed language takes effect July 1, 2013.

Not every organization that may provide information about itself in the public records is a "registered organization." For example, a general partnership is not a "registered organization," even if it files a statement of partnership authority under Section 303 of the Uniform Partnership Act (1994) or an assumed name ("dba") certificate. This is because the State under whose law the partnership is organized is not required to maintain a public record showing that the partnership has been organized. In contrast, corporations, limited liability companies, and limited partnerships are "registered organizations."

Note: This version of this paragraph is effective until July 1, 2013.

Not every organization that may provide information about itself in the public records is a "registered organization." For example, a general partnership is not a "registered organization," even if it files a statement of partnership authority under Section 303 of the Uniform Partnership Act (1994) or an assumed name ("dba") certificate. This is because such a partnership is not formed or organized by the filing of a record with, or the issuance of a record by, a State or the United States. In contrast, corporations, limited liability companies, and limited partnerships ordinarily are "registered organizations."

Note: This version of this paragraph takes effect July 1, 2013.

[Not every record concerning a registered organization that is filed with, or issued by, a State or the United States is a "public organic record." For example, a certificate of good standing issued with respect to a corporation or a published index of domestic corporations would not be a "public organic record" because its issuance or publication does not form or organize the corporations named.]

Note: The bracketed language takes effect July 1, 2013.

[When collateral is held in a trust, one must look to non-UCC law to determine whether the trust is a "registered organization." Non-UCC law typically distinguishes between statutory trusts and common-law trusts. A statutory trust is formed by the filing of a record, commonly referred to as a certificate of trust, in a public office pursuant to a statute. See, e.g., Uniform Statutory Trust Entity Act § 201 (2009); Delaware Statutory Trust Act, Del. Code Ann. tit. 12, § 3801 et seq. A statutory trust is a juridical entity, separate from its trustee and beneficial owners, that may sue and be sued, own property, and transact business in its own name. Inasmuch as a statutory trust is a "legal or commercial entity," it qualifies as a "person other than an individual," and therefore as an "organization," under Section 1-201. A statutory trust that is formed by the filing of a record in a public office is a "registered organization," and the filed record is a "public organic record" of the statutory trust, if the filed record is available to the public for inspection. (The requirement that a record be "available to the public for inspection" is satisfied if a copy of the relevant record is available for public inspection.)]

Note: The bracketed language takes effect July 1, 2013.

[Unlike a statutory trust, a common-law trust — whether its purpose is donative or commercial — arises from private action without the filing of a record in a public office. See Uniform Trust Code § 401 (2000); Restatement (Third) of Trusts § 10 (2003). Moreover, under traditional law, a common-law trust is not itself a juridical entity and therefore must sue and be sued, own property, and transact business in the name of the trustee acting in the capacity of trustee. A common-law trust that is a "business trust," i.e., that has a business or commercial purpose, is an "organization" under Section 1-201. However, such a trust would not be a "registered organization" if, as is typically the case, the filing of a public record is not needed to form it.]

Note: The bracketed language takes effect July 1, 2013.

[In some states, however, the trustee of a common-law trust that has a commercial or business purpose is required by statute to file a record in a public office following the trust's formation. See, e.g., Mass. Gen. Laws Ch. 182, § 2; Fla. Stat. Ann. § 609.02. A business trust that is required to file its organic record in a public office is a "registered organization" under the second sentence of the definition if the filed record is available to the public for inspection. Any organic record required to be filed, and filed, with respect to a common-law business trust after the trust is formed is a "public organic record" of the trust. Some statutes require a trust or other organization to file, after formation or organization, a record other than an organic record. See, e.g., N.Y. Gen Assn's Law § 18 (requiring associations doing business within New York to file a certificate designating the secretary of state as an agent upon whom process may be served). This requirement does not render the organization a "registered organization" under the second sentence of the definition, and the record is not a "public organic record."]

Note: The bracketed language takes effect July 1, 2013.

12. **Deposit-Account-Related Definitions: "Deposit Account"; "Bank."** The revised definition of "deposit account" incorporates the definition of "bank," which is new. The definition derives from the definitions of "bank" in Sections 4-105(1) and 4A-105(a)(2), which focus on whether the organization is "engaged in the business of banking."

Deposit accounts evidenced by Article 9 "instruments" are excluded from the term "deposit account." In contrast, former Section 9-105 excluded from the former definition "an account evidenced by a certificate of deposit." The revised definition clarifies the proper treatment of nonnegotiable or uncertificated certificates of deposit. Under the definition, an uncertificated certificate of deposit would be a deposit account (assuming there is no writing evidencing the bank's obligation to pay) whereas a nonnegotiable certificate of deposit would be a deposit account only if it is not an "instrument" as defined in this section (a question that turns on whether the nonnegotiable certificate of deposit is "of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment.")

A deposit account evidenced by an instrument is subject to the rules applicable to instruments generally. As a consequence, a security interest in such an instrument cannot be perfected by "control" (see Section 9-104), and the special priority rules applicable to deposit accounts (see Sections 9-327 and 9-340) do not apply.

The term "deposit account" does not include "investment property," such as securities and security entitlements. Thus, the term also does not include shares in a money-market mutual fund, even if the shares are redeemable by check.

13. **Proceeds-Related Definitions: "Cash Proceeds"; "Noncash Proceeds"; "Proceeds."** The revised definition of "proceeds" expands the definition beyond that contained in former Section 9-306 and resolves ambiguities in the former section.

a. **Distributions on Account of Collateral.** The phrase "whatever is collected on, or distributed on account of, collateral," in subparagraph (B), is broad enough to cover cash or stock dividends distributed on account of securities or other investment property that is original collateral. Compare former Section 9-306 ("Any payments or distributions made with respect to investment property collateral are proceeds."). This section rejects the holding of *Hastie v. FDIC*, 2 F.3d 1042 (10th Cir. 1993) (postpetition cash dividends on stock subject to a prepetition pledge are not "proceeds" under Bankruptcy Code Section 552(b)), to the extent the holding relies on the Article 9 definition of "proceeds."

b. **Distributions on Account of Supporting Obligations.** Under subparagraph (B), collections on and distributions on account of collateral consisting of various credit-support arrangements ("supporting obligations," as defined in Section 9-102) also are proceeds. Consequently, they are afforded treatment identical to proceeds collected from or distributed by the obligor on the underlying (supported) right to payment or other collateral. Proceeds of supporting obligations also are proceeds of the underlying rights to payment or other collateral.

c. **Proceeds of Proceeds.** The definition of "proceeds" no longer provides that proceeds of proceeds are themselves proceeds. That idea is expressed in the revised definition of "collateral" in Section 9-102. No change in meaning is intended.

d. **Proceeds Received by Person Who Did Not Create Security Interest.** When collateral is sold subject to a security interest and the buyer then resells the collateral, a question arose under former Article 9 concerning whether the "debtor" had "received" what the buyer received on resale and, therefore, whether those receipts were "proceeds" under former Section 9-306(2). This Article contains no requirement that property be "received" by the debtor for the property to qualify as proceeds. It is necessary only that the property be traceable, directly or indirectly, to the original collateral.

e. **Cash Proceeds and Noncash Proceeds.** The definition of "cash proceeds" is substantially the same as the corresponding definition in former Section 9-306. The phrase "and the like" covers property that is functionally equivalent to "money, checks, or deposit accounts," such as some money-market accounts that are securities

or part of securities entitlements. Proceeds other than cash proceeds are noncash proceeds.

14. **Consignment-Related Definitions: "Consignee"; "Consignment"; "Consignor."** The definition of "consignment" excludes, in subparagraphs (B) and (C), transactions for which filing would be inappropriate or of insufficient benefit to justify the costs. A consignment excluded from the application of this Article by one of those subparagraphs may still be a true consignment; however, it is governed by non-Article 9 law. The definition also excludes, in subparagraph (D), what have been called "consignments intended for security." These "consignments" are not bailments but secured transactions. Accordingly, all of Article 9 applies to them. See Sections 1-201(37), 9-109(a)(1). The "consignor" is the person who delivers goods to the "consignee" in a consignment.

Note: "Sections 1-201(37)," in the second to last sentence will be replaced with "Sections 1-201(b)(35)," effective July 1, 2013.

The definition of "consignment" requires that the goods be delivered "to a merchant for the purpose of sale." If the goods are delivered for another purpose as well, such as milling or processing, the transaction is a consignment nonetheless because a purpose of the delivery is "sale." On the other hand, if a merchant-processor-bailee will not be selling the goods itself but will be delivering to buyers to which the owner-bailor agreed to sell the goods, the transaction would not be a consignment.

15. **"Accounting."** This definition describes the record and information that a debtor is entitled to request under Section 9-210.

16. **"Document."** The definition of "document" is unchanged in substance from the corresponding definitions in former Section 9-105. See Section 1-201(15) and Comment 15.

Note: This version of this paragraph is effective until July 1, 2013.

16. **"Document."** The definition of "document" incorporates both tangible and electronic documents of title. See Section 1-201(b)(16) and Comment 16.

Note: This version of this paragraph is effective July 1, 2013.

17. **"Encumbrance"; "Mortgage."** The definitions of "encumbrance" and "mortgage" are unchanged in substance from the corresponding definitions in former Section 9-105. They are used primarily in the special real-property-related priority and other provisions relating to crops, fixtures, and accessions.

18. **"Fixtures."** This definition is unchanged in substance from the corresponding definition in former Section 9-313. See Section 9-334 (priority of security interests in fixtures and crops).

19. **"Good Faith."** This Article expands the definition of "good faith" to include "the observance of reasonable commercial standards of fair dealing." The definition in this section applies when the term is used in this Article, and the same concept applies in the context of this Article for purposes of the obligation of good faith imposed by Section 1-203. See subsection (c).

20. **"Lien Creditor"** This definition is unchanged in substance from the corresponding definition in former Section 9-301.

21. **"New Value."** This Article deletes former Section 9-108. Its broad formulation of new value, which embraced the taking of after-acquired collateral for a pre-existing claim, was unnecessary, counterintuitive, and ineffective for its original purpose of sheltering after-acquired collateral from attack as a voidable preference in bankruptcy. The new definition derives from Bankruptcy Code Section 547(a). The term is used with respect to temporary perfection of security interests in instruments, certificated securities, or negotiable documents under Section 9-312(e) and with respect to chattel paper priority in Section 9-330.

22. **"Person Related To."** Section 9-615 provides a special method for calculating a deficiency or surplus when "the secured party, a person related to the secured party, or a secondary obligor" acquires the collateral at a foreclosure disposition. Separate definitions of the term are provided with respect to an individual secured party and with respect to a secured party that is an organization. The definitions are patterned on the corresponding definition in Section 1.301(32) of the Uniform Consumer Credit Code (1974).

23. **"Proposal."** This definition describes a record that is sufficient to propose to retain collateral in full or partial satisfaction of a secured obligation. See Sections 9-620, 9-621, 9-622.

24. **"Pursuant to Commitment."** This definition is unchanged in substance from the corresponding definition in former Section 9-105. It is used in connection with special priority rules applicable to future advances. See Section 9-323.

25. **"Software."** The definition of "software" is used in connection with the priority rules applicable to purchase-money security interests. See Sections 9-103, 9-324. Software, like a payment intangible, is a type of general intangible for purposes of this Article. See Comment 4.a., above, regarding the distinction between "goods" and "software."

26. **Terminology: "Assignment" and "Transfer."** In numerous provisions, this Article refers to the "assignment" or the "transfer" of property interests. These terms and their derivatives are not defined. This Article generally follows common usage by using the terms "assignment" and "assign" to refer to transfers of rights to payment, claims, and liens and other security interests. It generally uses the term

"transfer" to refer to other transfers of interests in property. Except when used in connection with a letter-of-credit transaction (see Section 9-107, Comment 4), no significance should be placed on the use of one term or the other. Depending on the context, each term may refer to the assignment or transfer of an outright ownership interest or to the assignment or transfer of a limited interest, such as a security interest.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Commercial Law", see 58 Den. L.J. 279 (1981). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Commercial and Corporate Law", which discusses a recent Tenth Circuit decision dealing with perfection in proceeds in event of insolvency proceedings, see 65 Den. U. L. Rev. 469 (1988). For article, "Setoff and Security Interests In Deposit Accounts", see 17 Colo. Law. 2108 (1988).

Annotator's note. Since § 4-9-102 is similar to §§ 4-9-105, 4-9-106, 4-9-301, and 4-9-306 as they existed prior to the 2001 repeal and reenactment of this article, relevant cases construing those provisions have been included in the annotations to this section.

A debtor who makes representations in a security agreement regarding the intended use of collateral should be bound by those representations. That is especially true where the debtors fail to inform the creditor that they intend to use the collateral for other than personal, family, or household purposes. The classification of the collateral, for purposes of perfection of the security interest, is determined when the security interest attaches. The later use of the collateral for another purpose than as stated in the security agreement is irrelevant in determining whether the security interest is perfected. Nelson v. John Deere Credit, 340 B.R. 86 (Bankr. D. Colo. 2006).

Bank has security interest in proceeds generating "account". A bank has no security interest in the proceeds of either chickens or eggs, except to the extent such proceeds generated a prepetition "account" as defined in this section. K.L. Smith Enters., Ltd. v. United Bank, 2 Bankr. 280 (Bankr. D. Colo. 1980).

The right to collect annual campground membership dues is a right to payment for services rendered, which is an ordinary commercial account receivable. If the security interest is in accounts, the law of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or nonperfection of the security interest. Therefore, since the debtor was located at its place of business in Florida, Florida was the proper jurisdiction in which to file in order to perfect a security interest in the collateral, making the location of the collateral in Colorado irrelevant. Capitran Inc. v. Great Western Bank, 872 P.2d 1370 (Colo. App. 1994).

"Debtor" construed. Accommodation comakers and those others who will be called upon to pay deficiencies are "debtors" within the meaning of subsection (1)(d) and § 4-9-504 (3), and are entitled to notice of the disposition of the collateral. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

"Debtor" includes both the owner of the collateral and the obligor when they are not the same person. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

Subsection (1)(d) does not require "debtor" to be owner or have rights in the collateral. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

"Debtor" includes a guarantor and as a debtor the guarantor may not waive debtor's right to insist on a commercially reasonable disposition of collateral. May v. Women's Bank, N.A., 807 P.2d 1145 (Colo. 1991).

Definition of "goods" includes motor homes. People ex rel. VanMeveren v. District Court, 619 P.2d 494 (Colo. 1980).

An unperfected security interest becomes subordinate to the rights acquired by a lien creditor when a writ of garnishment is served on the garnishee at a time when the garnishor has no notice of the security interest. Welbourne Dev. Co. v. Affiliated Clearance Corp., 28 Colo. App. 313, 472 P.2d 684 (1970).

For the inconsistency between § 4-9-203 and this section on subject of proceeds, see Fort Collins Prod. Credit Ass'n v. Carroll Dairy, 37 Colo. App. 536, 553 P.2d 95 (1976) (decided prior to the 1977 amendment of this section and § 4-9-203).

Nothing in the language of subsection (1) requires that the disposition of collateral must be final in order to generate proceeds. In re Clancy & Co. Const., Inc., 214 Bankr. 387 (Bankr. D. Colo. 1997).

Effect of failure to use word "proceeds" in security agreement. Even absent use of the specific word "proceeds" in a security agreement, the lender continues, under the uniform commercial code, to have a secured interest in money received from the sale of personalty covered specifically in the agreement. Fort Collins Prod. Credit Ass'n v. Carroll Dairy, 37 Colo. App. 536, 553 P.2d 95 (1976).

Cattle which eat feed in which there is a security interest do not constitute proceeds of

the collateral by application of this section. First Nat'l Bank v. Bostron, 39 Colo. App. 107, 564 P.2d 964 (1977).

There could be no traceable "proceeds" to which a security interest in cattle feed may be said to have attached when the cattle have consumed the feed, and therefore such a security interest could not survive consumption of the feed by the cattle. First Nat'l Bank v. Bostron, 37 Colo. App. 107, 564 P.2d 964 (1977).

Wool incentive payments are "proceeds" of the wool. In re Mahleres, 53 Bankr. 86 (Bankr. D. Colo. 1985).

Satisfaction of judgment constituted only "identifiable proceeds in the hands of the debtor", when the debtor paid to judgment creditor the cash proceeds of sale of equipment in which bank held security interest, and thus bank in enforcing its security interest in identifiable proceeds of sale was not entitled to recover from judgment creditor the amount paid by debtor. First Interstate Bank v. Arizona Agrochemical, 731 P.2d 746 (Colo. App. 1986).

Applied in Welbourne Dev. Co. v. Affiliated Clearance Corp., 28 Colo. App. 313, 472 P.2d 684 (1970); Rocky Mt. Ass'n of Credit Mgt. v. Hessler Mfg. Co., 37 Colo. App. 551, 553 P.2d 840 (1976); Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977); Bd. of County Comm'rs v. Berkeley Vill., 40 Colo. App. 431, 580 P.2d 1251 (1978); Dept. of Natural Res. v. Benjamin, 41 Colo. App. 520, 587 P.2d 1207 (1978); Weld Colo. Bank v. E & E Constr., Inc., 653 P.2d 758 (Colo. App. 1982); Heinrichsdorff v. Raat, 655 P.2d 860 (Colo. App. 1982).

4-9-103. Purchase-money security interest - application of payments - burden of establishing - definitions. (a) In this section:

(1) "Purchase-money collateral" means goods or software that secures a purchase-money obligation incurred with respect to that collateral; and

(2) "Purchase-money obligation" means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

(b) A security interest in goods is a purchase-money security interest:

(1) To the extent that the goods are purchase-money collateral with respect to that security interest;

(2) If the security interest is in inventory that is or was purchase-money collateral, also to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase-money security interest; and

(3) Also to the extent that the security interest secures a purchase-money obligation incurred with respect to software in which the secured party holds or held a purchase-money security interest.

(c) A security interest in software is a purchase-money security interest to the extent that the security interest also secures a purchase-money obligation incurred with respect to goods in which the secured party holds or held a purchase-money security interest if:

(1) The debtor acquired its interest in the software in an integrated transaction in which it acquired an interest in the goods; and

(2) The debtor acquired its interest in the software for the principal purpose of using the software in the goods.

(d) The security interest of a consignor in goods that are the subject of a consignment is a purchase-money security interest in inventory.

(e) In a transaction other than a consumer-goods transaction, if the extent to which a security interest is a purchase-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

(1) In accordance with any reasonable method of application to which the parties agree;

(2) In the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or

(3) In the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:

(A) To obligations that are not secured; and

(B) If more than one obligation is secured, to obligations secured by purchase-money security interests in the order in which those obligations were incurred.

(f) In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if:

(1) The purchase-money collateral also secures an obligation that is not a purchase-money obligation;

(2) Collateral that is not purchase-money collateral also secures the purchase-money obligation; or

(3) The purchase-money obligation has been renewed, refinanced, consolidated, or restructured.

(g) In a transaction other than a consumer-goods transaction, a secured party claiming a purchase-money security interest has the burden of establishing the extent to which the security interest is a purchase-money security interest.

(h) The limitation of the rules in subsections (e), (f), and (g) of this section to transactions other than consumer-goods transactions is intended to leave to the court the determination of the proper rules in consumer-goods transactions. The court may not infer from that limitation the nature of the proper rule in consumer-goods transactions and may continue to apply established approaches.

Source: L. 2001: Entire article R&RE, p. 1327, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-107 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-107.

2. **Scope of This Section.** Under Section 9-309(1), a purchase-money security interest in consumer goods is perfected when it attaches. Sections 9-317 and 9-324 provide special priority rules for purchase-money security interests in a variety of contexts. This section explains when a security interest enjoys purchase-money status.

3. **"Purchase-Money Collateral"; "Purchase-Money Obligation"; "Purchase-Money Security Interest."** Subsection (a) defines "purchase-money collateral" and "purchase- money obligation." These terms are essential to the description of what constitutes a purchase-money security interest under subsection (b). As used in subsection (a)(2), the definition of "purchase-money obligation," the "price" of collateral or the "value given to enable" includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.

The concept of "purchase-money security interest" requires a close nexus between the acquisition of collateral and the secured obligation. Thus, a security interest does not qualify as a purchase-money security interest if a debtor acquires property on unsecured credit and subsequently creates the security interest to secure the purchase price.

4. **Cross-Collateralization of Purchase-Money Security Interests in Inventory.** Subsection (b)(2) deals with the problem of cross-collateralized purchase-money security interests in inventory. Consider a simple example:

Example: Seller (S) sells an item of inventory (Item-1) to Debtor (D), retaining a security interest in Item-1 to secure Item-1's price and all other obligations, existing and future, of D to S. S then sells another item of inventory to D (Item-2), again retaining a security interest in Item-2 to secure Item-2's price as well as all other obligations of D to S. D then pays to S Item-1's price. D then sells Item-2 to a buyer in ordinary course of business, who takes Item-2 free of S's security interest.

Under subsection (b)(2), S's security interest in *Item-1* securing *Item-2's unpaid price* would be a purchase-money security interest. This is so because S has a purchase-money security interest in Item-1, Item-1 secures the price of (a "purchase-money obligation incurred with respect to") Item-2 ("other inventory"), and Item-2 itself was subject to a purchase-money security interest. Note that, to the extent Item-1 secures the price of Item-2, S's security interest in Item-1 would not be a purchase-money security interest under subsection (b)(1). The security interest in Item-1 is a purchase-money security interest under subsection (b)(1) only to the extent that Item-1 is "purchase-money collateral," i.e., only to the extent that Item-1 "secures a purchase-money obligation incurred with respect to that collateral" (i.e., Item-1). See subsection (a)(1).

5. **Purchase-Money Security Interests in Goods and Software.** Subsections (b) and (c) limit purchase-money security interests to security interests in goods, including fixtures, and software. Otherwise, no change in meaning from former Section 9-107 is intended. The second sentence of former Section 9-115(5)(f) made the purchase-money priority rule (former Section 9-312(4)) inapplicable to investment

property. This section's limitation makes that provision unnecessary.

Subsection (c) describes the limited circumstances under which a security interest in goods may be accompanied by a purchase-money security interest in software. The software must be acquired by the debtor in a transaction integrated with the transaction in which the debtor acquired the goods, and the debtor must acquire the software for the principal purpose of using the software in the goods. "Software" is defined in Section 9-102.

6. **Consignments.** Under former Section 9-114, the priority of the consignor's interest is similar to that of a purchase-money security interest. Subsection (d) achieves this result more directly, by defining the interest of a "consignor," defined in Section 9-102, to be a purchase-money security interest in inventory for purposes of this Article. This drafting convention obviates any need to set forth special priority rules applicable to the interest of a consignor. Rather, the priority of the consignor's interest as against the rights of lien creditors of the consignee, competing secured parties, and purchasers of the goods from the consignee can be determined by reference to the priority rules generally applicable to inventory, such as Sections 9-317, 9-320, 9-322, and 9-324. For other purposes, including the rights and duties of the consignor and consignee as between themselves, the consignor would remain the owner of goods under a bailment arrangement with the consignee. See Section 9-319.

7. **Provisions Applicable Only to Non-Consumer-Goods Transactions.**

a. **"Dual-Status" Rule.** For transactions other than consumer-goods transactions, this Article approves what some cases have called the "dual-status" rule, under which a security interest may be a purchase-money security interest to some extent and a non-purchase-money security interest to some extent. (Concerning consumer-goods transactions, see subsection (h) and Comment 8.) Some courts have found this rule to be explicit or implicit in the words "to the extent," found in former Section 9-107 and continued in subsections (b)(1) and (b)(2). The rule is made explicit in subsection (e). For non-consumer-goods transactions, this Article rejects the "transformation" rule adopted by some cases, under which any cross-collateralization, refinancing, or the like destroys the purchase-money status entirely.

Consider, for example, what happens when a $10,000 loan secured by a purchase- money security interest is refinanced by the original lender, and, as part of the transaction, the debtor borrows an additional $2,000 secured by the collateral. Subsection (f) resolves any doubt that the security interest remains a purchase-money security interest. Under subsection (b), however, it enjoys purchase-money status only to the extent of $10,000.

b. **Allocation of Payments.** Continuing with the example, if the debtor makes a $1,000 payment on the $12,000 obligation, then one must determine the extent to which the security interest remains a purchase-money security interest $9,000 or $10,000. Subsection (e)(1) expresses the overriding principle, applicable in cases other than consumer-goods transactions, for determining the extent to which a security interest is a purchase-money security interest under these circumstances: freedom of contract, as limited by principle of reasonableness. An unconscionable method of application, for example, is not a reasonable one and so would not be given effect under subsection (e)(1). In the absence of agreement, subsection (e)(2) permits the obligor to determine how payments should be allocated. If the obligor fails to manifest its intention, obligations that are not secured will be paid first. (As used in this Article, the concept of "obligations that are not secured" means obligations for which the debtor has not created a security interest. This concept is different from and should not be confused with the concept of an "unsecured claim" as it appears in Bankruptcy Code Section 506(a).) The obligor may prefer this approach, because unsecured debt is likely to carry a higher interest rate than secured debt. A creditor who would prefer to be secured rather than unsecured also would prefer this approach.

After the unsecured debt is paid, payments are to be applied first toward the obligations secured by purchase-money security interests. In the event that there is more than one such obligation, payments first received are to be applied to obligations first incurred. See subsection (e)(3). Once these obligations are paid, there are no purchase-money security interests and no additional allocation rules are needed.

Subsection (f) buttresses the dual-status rule by making it clear that (in a transaction other than a consumer-goods transaction) cross-collateralization and renewals, refinancings, and restructurings do not cause a purchase-money security interest to lose its status as such. The statutory terms "renewed," "refinanced," and "restructured" are not defined. Whether the terms encompass a particular transaction depends upon whether, under the particular facts, the purchase-money character of the security interest fairly can be said to survive. Each term contemplates that an identifiable portion of the purchase-money obligation could be traced to the new obligation resulting from a renewal, refinancing, or restructuring.

c. **Burden of Proof.** As is the case when the extent of a security interest is in issue, under subsection (g) the secured party claiming a purchase-money security interest in a transaction other than a consumer-goods transaction has the

burden of establishing whether the security interest retains its purchase-money status. This is so whether the determination is to be made following a renewal, refinancing, or restructuring or otherwise.

8. **Consumer-Goods Transactions; Characterization Under Other Law.** Under subsection (h), the limitation of subsections (e), (f), and (g) to transactions other than consumer-goods transactions leaves to the court the determination of the proper rules in consumer-goods transactions. Subsection (h) also instructs the court not to draw any inference from this limitation as to the proper rules for consumer-goods transactions and leaves the court free to continue to apply established approaches to those transactions.

This section addresses only whether a security interest is a "purchase-money security interest" under this Article, primarily for purposes of perfection and priority. See, e.g., Sections 9-317, 9-324. In particular, its adoption of the dual-status rule, allocation of payments rules, and burden of proof standards for non-consumer-goods transactions is not intended to affect or influence characterizations under other statutes. Whether a security interest is a "purchase-money security interest" under other law is determined by that law. For example, decisions under Bankruptcy Code Section 522(f) have applied both the dual-status and the transformation rules. The Bankruptcy Code does not expressly adopt the state law definition of "purchase-money security interest." Where federal law does not defer to this Article, this Article does not, and could not, determine a question of federal law.

ANNOTATION

Annotator's note. Since § 4-9-103 is similar to § 4-9-107 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

A purchase money security interest in property takes precedence over any preexisting lien. Chambers v. Nation, 178 Colo. 124, 497 P.2d 5 (1972).

If property comes into the hands of a purchaser already encumbered with a purchase money lien, a prior lien remains subordinate to the purchase money mortgage, and it cannot displace the security interest which is the subject matter of the purchase money agreement. Chambers v. Nation, 178 Colo. 124, 497 P.2d 5 (1972).

Loan may be partly purchase money and partly nonpurchase money. There is no requirement that an item secure only its purchase price, and a loan may be partly purchase money and partly nonpurchase money. In re Stevens, 24 Bankr. 536 (Bankr. D. Colo. 1982).

The purchase money character of a security interest should be determined from all the surrounding circumstances. In re Stevens, 24 Bankr. 536 (Bankr. D. Colo. 1982); In re Billings, 63 Bankr. 717 (Bankr. D. Colo. 1986).

Refinancing will not always have the effect of destroying the purchase money security interest. In re Billings, 63 Bankr. 717 (Bankr. D. Colo. 1986).

Refinancing of a purchase money loan does not automatically extinguish the creditor's purchase money security interest in the debtor's collateral and, thus, debtors could not avoid creditor's interest in bankruptcy proceeding. In re Billings, 838 F.2d 405 (10th Cir. 1988).

Negative equity financing of a vehicle trade-in is not a purchase-money obligation. In re McCauley, 398 B.R. 41 (Bankr. D. Colo. 2008).

Bankruptcy court applied dual status rule to case involving financing of negative equity on a vehicle trade-in. Lender had a purchase-money security interest only to the extent of the purchase price of the new vehicle and the incidental transactional expenses. Financing of negative equity for trade-in vehicle was not entitled to purchase-money security interest treatment. Thus debtors had to treat proportion of debt attributable to purchase price of new vehicle and the incidental expenses as a secured claim. In re McCauley, 398 B.R. 41 (Bankr. D. Colo. 2008).

4-9-104. Control of deposit account. (a) A secured party has control of a deposit account if:

(1) The secured party is the bank with which the deposit account is maintained;

(2) The debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or

(3) The secured party becomes the bank's customer with respect to the deposit account.

(b) A secured party that has satisfied subsection (a) of this section has control, even if the debtor retains the right to direct the disposition of funds from the deposit account.

Source: L. 2001: Entire article R&RE, p. 1328, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New; derived from Section 8-106.

2. **Why "Control" Matters.** This section explains the concept of "control" of a deposit account. "Control" under this section may serve two functions. First, "control . . . pursuant to the debtor's agreement" may substitute for an authenticated security agreement as an element of attachment. See Section 9-203(b)(3)(D). Second, when a deposit account is taken as original collateral, the only method of perfection is obtaining control under this section. See Section 9-312(b)(1).

3. **Requirements for "Control."** This section derives from Section 8-106 of Revised Article 8, which defines "control" of securities and certain other investment property. Under subsection (a)(1), the bank with which the deposit account is maintained has control. The effect of this provision is to afford the bank automatic perfection. No other form of public notice is necessary; all actual and potential creditors of the debtor are always on notice that the bank with which the debtor's deposit account is maintained may assert a claim against the deposit account.

[**Example:** D maintains a deposit account with Bank A. To secure a loan from Banks X, Y, and Z, D creates a security interest in the deposit account in favor of Bank A, as agent for Banks X, Y, and Z. Because Bank A is a "secured party" as defined in Section 9-102, the security interest is perfected by control under subsection (a)(1).]

Note: The bracketed language takes effect July 1, 2013.

Under subsection (a)(2), a secured party may obtain control by obtaining the bank's authenticated agreement that it will comply with the secured party's instructions without further consent by the debtor. The analogous provision in Section 8-106 does not require that the agreement be authenticated. An agreement to comply with the secured party's instructions suffices for "control" of a deposit account under this section even if the bank's agreement is subject to specified conditions, e.g., that the secured party's instructions are accompanied by a certification that the debtor is in default. (Of course, if the condition is the *debtor's* further consent, the statute explicitly provides that the agreement would *not* confer control.) See revised Section 8-106, Comment 7.

Under subsection (a)(3), a secured party may obtain control by becoming the bank's "customer," as defined in Section 4-104. As the customer, the secured party would enjoy the right (but not necessarily the exclusive right) to withdraw funds from, or close, the deposit account. See Sections 4-401(a), 4-403(a).

[As is the case with possession under Section 9-313, in determining whether a particular person has control under subsection (a), the principles of agency apply. See Section 1-103 and Restatement (3d), Agency § 8.12, Comment *b*.]

Note: The bracketed language takes effect July 1, 2013.

Although the arrangements giving rise to control may themselves prevent, or may enable the secured party at its discretion to prevent, the debtor from reaching the funds on deposit, subsection (b) makes clear that the debtor's ability to reach the funds is not inconsistent with "control."

Perfection by control is not available for bank accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are "instruments" and not "deposit accounts." See Section 9-102 (defining "deposit account" and "instrument").

4-9-105. Control of electronic chattel paper. A secured party has control of electronic chattel paper if the record or records comprising the chattel paper are created, stored, and assigned in such a manner that:

(1) A single authoritative copy of the record or records exists which is unique, identifiable and, except as otherwise provided in paragraphs (4), (5), and (6) of this section, unalterable;

(2) The authoritative copy identifies the secured party as the assignee of the record or records;

(3) The authoritative copy is communicated to and maintained by the secured party or its designated custodian;

(4) Copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the participation of the secured party;

(5) Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) Any revision of the authoritative copy is readily identifiable as an authorized or unauthorized revision.

Editor's note: This version of this section is effective until July 1, 2013.

4-9-105. Control of electronic chattel paper. (a) A secured party has control of electronic chattel paper if a system employed for evidencing the transfer of interests in the chattel paper reliably establishes the secured party as the person to which the chattel paper was assigned.

(b) A system satisfies subsection (a) of this section if the record or records comprising the chattel paper are created, stored, and assigned in such a manner that:

(1) A single authoritative copy of the record or records exists that is unique, identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6) of this subsection (b), unalterable;

(2) The authoritative copy identifies the secured party as the assignee of the record or records;

(3) The authoritative copy is communicated to and maintained by the secured party or its designated custodian;

(4) Copies or amendments that add or change an identified assignee of the authoritative copy can be made only with the consent of the secured party;

(5) Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) Any amendment of the authoritative copy is readily identifiable as authorized or unauthorized.

Editor's note: This version of this section is effective July 1, 2013.

Source: L. 2001: Entire article R&RE, p. 1329, § 1, effective July 1. **L. 2012:** Entire section amended, (HB 12-1262), ch. 170, p. 596, § 2, effective July 1, 2013.

OFFICIAL COMMENT

1. **Source.** New.

2. **"Control" of Electronic Chattel Paper.** This Article covers security interests in "electronic chattel paper," a new term defined in Section 9-102. This section governs how "control" of electronic chattel paper may be obtained. [Subsection (a), which derives from Section 16 of the Uniform Electronic Transactions Act, sets forth the general test for control. Subsection (b) sets forth a safe harbor test that, if satisfied, establishes control under the general test in subsection (a).]

Note: The bracketed language takes effect July 1, 2013.

A secured party's control of electronic chattel paper (i) may substitute for an authenticated security agreement for purposes of attachment under Section 9-203, (ii) is a method of perfection under Section 9-314, and (iii) is a condition for obtaining special, non-temporal priority under Section 9-330. Because electronic chattel paper cannot be transferred, assigned, or possessed in the same manner as tangible chattel paper, a special definition of control is necessary. In descriptive terms, this section provides that control of electronic chattel paper is the functional equivalent of possession of "tangible chattel paper" (a term also defined in Section 9-102).

[3. **Development of Control Systems.** This Article leaves to the marketplace the development of systems and procedures, through a combination of suitable technologies and business practices, for dealing with control of electronic chattel paper in a commercial context. Systems that evolve for control of electronic chattel paper may or may not involve a third party custodian of the relevant records. As under UETA, a system must be shown to reliably establish that the secured party is the assignee of the chattel paper. Reliability is a high standard and encompasses the general principles of uniqueness, identifiability, and unalterability found in subsection (b) without setting forth specific guidelines as to how these principles must be achieved. However, the standards applied to determine whether a party is in control of electronic chattel paper should not be more stringent than the standards now applied to determine whether a party is in possession of tangible chattel paper. For example, just as a secured party does not lose possession of tangible chattel paper merely by virtue of the possibility that a person acting on its behalf *could* wrongfully redeliver the chattel paper to the debtor, so control of electronic chattel paper would not be defeated by the possibility that the secured party's interest *could* be subverted by the wrongful conduct of a person (such as a custodian) acting on its behalf.]

Note: The bracketed language takes effect July 1, 2013.

[This section and the concept of control of electronic chattel paper are not based on the same concepts as are control of deposit accounts (Section 9-104), security entitlements, a type of

investment property (Section 9-106), and letter-of-credit rights (Section 9-107). The rules for control of those types of collateral are based on existing market practices and legal and regulatory regimes for institutions such as banks and securities intermediaries. Analogous practices for electronic chattel paper are developing nonetheless. The flexible approach adopted by this section, moreover, should not impede the development of these practices and, eventually, legal and regulatory regimes, which may become analogous to those for, e.g., investment property.]

Note: The bracketed language takes effect July 1, 2013.

4. **"Authoritative Copy" of Electronic Chattel Paper.** One requirement for establishing control [under subsection (b)] is that a particular copy be an "authoritative copy. " Although other copies may exist, they must be distinguished from the authoritative copy. This may be achieved, for example, through the methods of authentication that are used or by business practices involving the marking of any additional copies. When tangible chattel paper is converted to electronic chattel paper, in order to establish that a copy of the electronic chattel paper is the authoritative copy it may be necessary to show that the tangible chattel paper no longer exists or has been permanently marked to indicate that it is not the authoritative copy.

Note: The bracketed language takes effect July 1, 2013.

[5. **Development of Control Systems.** This Article leaves to the marketplace the development of systems and procedures, through a combination of suitable technologies and business practices, for dealing with control of electronic chattel paper in a commercial context. However, achieving control under this section requires more than the agreement of interested persons that the elements of control are satisfied. For example, paragraph (4) contemplates that control requires that it be a physical impossibility (or sufficiently unlikely or implausible so as to approach practical impossibility) to add or change an identified assignee without the participation of the secured party (or its authorized representative). It would not be enough for the assignor merely to agree that it will not change the identified assignee without the assignee-secured party's consent. However, the standards applied to determine whether a party is in control of electronic chattel paper should not be more stringent than the standards now applied to determine whether a party is in possession of tangible chattel paper. Control of electronic chattel paper contemplates systems or procedures such that the secured party must take some action (either directly or through its designated custodian) to effect a change or addition to the authoritative copy. But just as a secured party does not lose possession of tangible chattel paper merely by virtue of the possibility that a person acting on its behalf *could* wrongfully redeliver the chattel paper to the debtor, so control of electronic chattel paper would not be defeated by the possibility that the secured party's interest *could* be subverted by the wrongful conduct of a person (such as a custodian) acting on its behalf.]

Note: The bracketed language will be deleted effective July 1, 2013.

[Systems that evolve for control of electronic chattel paper may or may not involve a third party custodian of the relevant records. However, this section and the concept of control of electronic chattel paper are not based on the same concepts as are control of deposit accounts (Section 9-104), security entitlements, a type of investment property (Section 9-106), and letter-of-credit rights (Section 9-107). The rules for control of that collateral are based on existing market practices and legal and regulatory regimes for institutions such as banks and securities intermediaries. Analogous practices for electronic chattel paper are developing nonetheless. The flexible approach adopted by this section, moreover, should not impede the development of these practices and, eventually, legal and regulatory regimes, which may become analogous to those for, e.g., investment property.]

Note: The bracketed language will be deleted effective July 1, 2013.

4-9-106. Control of investment property. (a) A person has control of a certificated security, uncertificated security, or security entitlement as provided in section 4-8-106.

(b) A secured party has control of a commodity contract if:

(1) The secured party is the commodity intermediary with which the commodity contract is carried; or

(2) The commodity customer, secured party, and commodity intermediary have agreed that the commodity intermediary will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer.

(c) A secured party having control of all security entitlements or commodity contracts carried in a securities account or commodity account has control over the securities account or commodity account.

Source: L. 2001: Entire article R&RE, p. 1329, § 1, effective July 1.

Editor's note: The provisions of this section are similar to former §§ 4-9-115 (e) and 4-8-106 as they existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-115(e).
2. **"Control" Under Article 8.** For an explanation of "control" of securities and certain other investment property, see Section 8-106, Comments 4 and 7.
3. **"Control" of Commodity Contracts.** This section, as did former Section 9-115(1)(e), contains provisions relating to control of commodity contracts which are analogous to those in Section 8-106 for other types of investment property.
4. **Securities Accounts and Commodity Accounts.** For drafting convenience, control with respect to a securities account or commodity account is defined in terms of obtaining control over the security entitlements or commodity contracts. Of course, an agreement that provides that (without further consent of the debtor) the securities intermediary or commodity intermediary will honor instructions from the secured party concerning a securities account or commodity account described as such is sufficient. Such an agreement necessarily implies that the intermediary will honor instructions concerning all security entitlements or commodity contracts carried in the account and thus affords the secured party control of all the security entitlements or commodity contracts.

4-9-107. Control of letter-of-credit right. A secured party has control of a letter-of-credit right to the extent of any right to payment or performance by the issuer or any nominated person if the issuer or nominated person has consented to an assignment of proceeds of the letter of credit under section 4-5-114 (c) or otherwise applicable law or practice.

Source: L. 2001: Entire article R&RE, p. 1330, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.
2. **"Control" of Letter-of-Credit Right.** Whether a secured party has control of a letter-of-credit right may determine the secured party's priority as against competing secured parties. See Section 9-329. This section provides that a secured party acquires control of a letter-of-credit right by receiving an assignment if the secured party obtains the consent of the issuer or any nominated person, such as a confirmer or negotiating bank, under Section 5-114 or other applicable law or practice. Because both issuers and nominated persons may give or be obligated to give value under a letter of credit, this section contemplates that a secured party obtains control of a letter-of-credit right with respect to the issuer or a particular nominated person only to the extent that the issuer or that nominated person consents to the assignment. For example, if a secured party obtains control to the extent of an issuer's obligation but fails to obtain the consent of a nominated person, the secured party does not have control to the extent that the nominated person gives value. In many cases the person or persons who will give value under a letter of credit will be clear from its terms. In other cases, prudence may suggest obtaining consent from more than one person. The details of the consenting issuer's or nominated person's duties to pay or otherwise render performance to the secured party are left to the agreement of the parties.
3. **"Proceeds of a Letter of Credit."** Section 5-114 follows traditional banking terminology by referring to a letter of credit beneficiary's assignment of its right to receive payment thereunder as an assignment of the "proceeds of a letter of credit." However, as the seller of goods can assign its right to receive payment (an "account") before it has been earned by delivering the goods to the buyer, so the beneficiary of a letter of credit can assign its contingent right to payment before the letter of credit has been honored. See Section 5-114(b). If the assignment creates a security interest, the security interest can be perfected at the time it is created. An assignment of, including the creation of a security interest in, a letter-of-credit right is an assignment of a present interest.
4. **"Transfer" vs. "Assignment."** Letter-of-credit law and practice distinguish the "transfer" of a letter of credit from an "assignment." Under a transfer, the transferee itself becomes the beneficiary and acquires the right to draw. Whether a new, substitute credit is issued or the issuer advises the transferee of its status as such,

the transfer constitutes a novation under which the transferee is the new, substituted beneficiary (but only to the extent of the transfer, in the case of a partial transfer).

Section 5-114(e) provides that the rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds. For this reason, transfer does not appear in this Article as a means of control or perfection. Section 9-109(c)(4) recognizes the independent and superior rights of a transferee beneficiary under Section 5-114(e); this Article does not apply to the rights of a transferee beneficiary or nominated person to the extent that those rights are independent and superior under Section 5-114.

5. **Supporting Obligation: Automatic Attachment and Perfection.** A letter-of-credit right is a type of "supporting obligation," as defined in Section 9-102. Under Sections 9-203 and 9-308, a security interest in a letter-of-credit right automatically attaches and is automatically perfected if the security interest in the supported obligation is a perfected security interest. However, unless the secured party has control of the letter-of-credit right or itself becomes a transferee beneficiary, it cannot obtain any rights against the issuer or a nominated person under Article 5. Consequently, as a practical matter, the secured party's rights would be limited to its ability to locate and identify proceeds distributed by the issuer or nominated person under the letter of credit.

4-9-108. Sufficiency of description. (a) Except as otherwise provided in subsections (c), (d), (e), and (f) of this section, a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.

(b) Except as otherwise provided in subsection (d) of this section, a description of collateral reasonably identifies the collateral if it identifies the collateral by:

(1) Specific listing;

(2) Category, including a category determined by use of a numerical or other code included in forms and formats adopted from time to time by the secretary of state;

(3) Except as otherwise provided in subsection (e) of this section, a type of collateral defined in this title;

(4) Quantity;

(5) Computational or allocational formula or procedure; or

(6) Except as otherwise provided in subsection (c) of this section, any other method, if the identity of the collateral is objectively determinable.

(c) A description of collateral as "all the debtor's assets" or "all the debtor's personal property" or using words of similar import does not reasonably identify the collateral.

(d) Except as otherwise provided in subsection (e) of this section, a description of a security entitlement, securities account, or commodity account is sufficient if it describes:

(1) The collateral by those terms or as investment property; or

(2) The underlying financial asset or commodity contract.

(e) A description only by type of collateral defined in this title is an insufficient description of:

(1) A commercial tort claim;

(2) In a consumer transaction, consumer goods, a security entitlement, a securities account, or a commodity account; or

(3) A deposit account.

(f) Any description in the security agreement of personal property that includes consumer goods is sufficient as to the consumer goods only if it specifically identifies and itemizes such consumer goods.

Source: L. 2001: Entire article R&RE, p. 1330, § 1, effective July 1.

Editor's note: (1) The provisions of this section are similar to former §§ 4-9-110 and 4- 9-115 (3) as they existed prior to 2001.

(2) **Colorado legislative change:** Colorado added the phrase "including a category determined by use of a numerical or other code included in forms and formats adopted from time to time by the secretary of state;" in subsection (b)(2), added a new paragraph (3) to subsection (e), and added a new subsection (f).

OFFICIAL COMMENT

1. **Source.** Former Sections 9-110, 9-115(3).

2. **General Rules.** Subsection (a) retains substantially the same formulation as former Section 9-110. Subsection (b) expands upon subsection (a) by indicating a variety of ways in which a description might reasonably identify collateral. Whereas a provision similar to subsection (b) was applicable only to investment property under former Section 9-115(3), subsection (b) applies to all types of collateral, subject to the limitation in subsection (d). Subsection (b) is subject to subsection (c), which follows prevailing case law and adopts the view that an "all assets" or "all personal property" description for purposes of a *security agreement* is *not* sufficient. Note, however, that under Section 9-504, a *financing statement* sufficiently indicates the collateral if it "covers all assets or all personal property."

The purpose of requiring a description of collateral in a security agreement under Section 9-203 is evidentiary. The test of sufficiency of a description under this section, as under former Section 9-110, is that the description do the job assigned to it: make possible the identification of the collateral described. This section rejects any requirement that a description is insufficient unless it is exact and detailed (the so-called "serial number" test).

3. **After-Acquired Collateral.** Much litigation has arisen over whether a description in a security agreement is sufficient to include after-acquired collateral if the agreement does not explicitly so provide. This question is one of contract interpretation and is not susceptible to a statutory rule (other than a rule to the effect that it is a question of contract interpretation). Accordingly, this section contains no reference to descriptions of after-acquired collateral.

4. **Investment Property.** Under subsection (d), the use of the wrong Article 8 terminology does not render a description invalid (e.g., a security agreement intended to cover a debtor's "security entitlements" is sufficient if it refers to the debtor's "securities"). Note also that given the broad definition of "securities account" in Section 8-501, a security interest in a securities account also includes all other rights of the debtor against the securities intermediary arising out of the securities account. For example, a security interest in a securities account would include credit balances due to the debtor from the securities intermediary, whether or not they are proceeds of a security entitlement. Moreover, describing collateral as a securities account is a simple way of describing all of the security entitlements carried in the account.

5. **Consumer Investment Property; Commercial Tort Claims.** Subsection (e) requires greater specificity of description in order to prevent debtors from inadvertently encumbering certain property. Subsection (e) requires that a description by defined "type" of collateral alone of a commercial tort claim or, in a consumer transaction, of a security entitlement, securities account, or commodity account, is not sufficient. For example, "all existing and after-acquired investment property" or "all existing and after-acquired security entitlements," without more, would be insufficient in a consumer transaction to describe a security entitlement, securities account, or commodity account. The reference to "*only* by type" in subsection (e) means that a description is sufficient if it satisfies subsection (a) and contains a descriptive component beyond the "type" alone. Moreover, if the collateral consists of a securities account or commodity account, a description of the account is sufficient to cover all existing and future security entitlements or commodity contracts carried in the account. See Section 9-203(h), (i).

Under Section 9-204, an after-acquired collateral clause in a security agreement will not reach future commercial tort claims. It follows that when an effective security agreement covering a commercial tort claim is entered into the claim already will exist. Subsection (e) does not require a description to be specific. For example, a description such as "all tort claims arising out of the explosion of debtor's factory" would suffice, even if the exact amount of the claim, the theory on which it may be based, and the identity of the tortfeasor(s) are not described. (Indeed, those facts may not be known at the time.)

ANNOTATION

Law reviews. For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For comment on In re Lehner appearing below, see 48 Den. L.J. 146 (1971). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

Annotator's note. Since § 4-9-108 is similar to § 4-9-110 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

This section is intended to demand specificity only in the security agreement. In re Lehner, 303 F. Supp. 317 (D. Colo. 1969), aff'd per curiam and reh'g denied, 427 F.2d 357 (10th Cir. 1970).

The sufficiency of the description in the financing statement is to be determined by § 4-9-402(1). In re Lehner, 303 F. Supp. 317 (D.

Colo. 1969), aff'd per curiam and reh'g denied, 427 F.2d 357 (10th Cir. 1970).

The use of the term "consumer goods" fails to satisfy this section. In re Lehner, 303 F. Supp. 317, (D. Colo. 1969), aff'd per curiam and reh'g denied, 427 F.2d 357 (10th Cir. 1970).

Applied in Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977).

4-9-109. Scope. (a) Except as otherwise provided in subsections (c), (d), and (e) of this section, this article applies to:

(1) A transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;

(2) An agricultural lien;

(3) A sale of accounts, chattel paper, payment intangibles, or promissory notes;

(4) A consignment;

(5) A security interest arising under section 4-2-401, 4-2-505, 4-2-711 (3), or 4-2.5-508 (5), as provided in section 4-9-110; and

(6) A security interest arising under section 4-4-210 or 4-5-117.5.

(b) The application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.

(c) This article does not apply to the extent that:

(1) A statute, regulation, or treaty of the United States preempts this article;

(2) A statute of this state governs or a constitutional provision provides authority for the creation, perfection, priority, or enforcement of tax liens;

(3) A statute of another state, a foreign country, or a governmental unit of another state or a foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority, or enforcement of a security interest created by the state, country, or governmental unit; or

(4) The rights of a transferee beneficiary or nominated person under a letter of credit are independent and superior under section 4-5-114.

(d) This article does not apply to:

(1) A landlord's lien, other than an agricultural lien;

(2) A lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but section 4-9-333 applies with respect to priority of the lien;

(3) An assignment of a claim for wages, salary, or other compensation of an employee;

(4) A sale of accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose;

(5) An assignment of accounts, chattel paper, payment intangibles, or promissory notes which is for the purpose of collection only;

(6) An assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract;

(7) An assignment of a single account, payment intangible, or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness;

(8) A transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment, but sections 4-9-315 and 4-9-322 apply with respect to proceeds and priorities in proceeds;

(9) An assignment of a right represented by a judgment, other than a judgment taken on a right to payment that was collateral;

(10) A right of recoupment or set-off, but:

(A) Section 4-9-340 applies with respect to the effectiveness of rights of recoupment or set-off against deposit accounts; and

(B) Section 4-9-404 applies with respect to defenses or claims of an account debtor;

(11) The creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for:

(A) Liens on real property in sections 4-9-203 and 4-9-308;

(B) Fixtures in section 4-9-334;

(C) Fixture filings in sections 4-9-501, 4-9-502, 4-9-512, 4-9-516, and 4-9-519; and

(D) Security agreements covering personal and real property in section 4-9-604;

(12) An assignment of a claim arising in tort, other than a commercial tort claim, but sections 4-9-315 and 4-9-322 apply with respect to proceeds and priorities in proceeds;

(13) An assignment of a consumer deposit account in any transaction, but sections 4-9-315 and 4-9-322 apply with respect to proceeds and priorities in proceeds;

(13.5) An assignment of a deposit account in transactions where the principal or the maximum line of credit on a revolving loan account do not exceed one hundred thousand dollars, but sections 4-9-315 and 4-9-322 apply with respect to proceeds and priorities in proceeds. A "revolving loan account" means an arrangement between a creditor and a debtor whereby the lender may permit the debtor, from time to time, to purchase or lease on credit or to obtain loans from the creditor.

(14) An assignment of an individual retirement account as defined in 26 U.S.C. sec. 408; or

(15) An assignment of any plan as defined in 26 U.S.C. sec. 401.

(e) The creation, perfection, priority, and enforcement of a security interest, lien, or pledge created by this state or a governmental unit of this state shall be governed by section 11-57-208 (2), C.R.S., and this article shall not apply to such a security interest, lien, or pledge regardless of whether, pursuant to section 11-57-204 (1), C.R.S., the state or such governmental unit elected to apply part 2 of article 57 of title 11, C.R.S., to such a security interest, lien, or pledge.

Source: L. 2001: Entire article R&RE, p. 1331, § 1, effective July 1.

Editor's note: (1) The provisions of this section are similar to former §§ 4-9-102 and 4-9-104 as they existed prior to 2001.

(2) **Colorado legislative change:** Colorado added subsection (e) to the list of exceptions in subsection (a) and added a new subsection (e). In subsection (c)(2), Colorado did not adopt the word "expressly" before the word "governs", added the phrase "or a constitutional provision provides authority for", and substituted the phrase "tax liens" for the phrase "a security interest created by this State or a governmental unit of this State". Colorado added new paragraphs (13.5), (14), and (15) to subsection (d).

OFFICIAL COMMENT

1. **Source.** Former Sections 9-102, 9-104.

2. **Basic Scope Provision.** Subsection (a)(1) derives from former Section 9-102(1) and (2). These subsections have been combined and shortened. No change in meaning is intended. Under subsection (a)(1), all consensual security interests in personal property and fixtures are covered by this Article, except for transactions excluded by subsections (c) and (d). As to which transactions give rise to a "security interest," the definition of that term in Section 1-201 must be consulted. When a security interest is created, this Article applies regardless of the form of the transaction or the name that parties have given to it. [Likewise, the subjective intention of the parties with respect to the legal characterization of their transaction is irrelevant to whether this Article applies, as it was to the application of former Article 9 under the proper interpretation of former Section 9-102.]

Note: The bracketed language takes effect July 1, 2013.

3. **Agricultural Liens.** Subsection (a)(2) is new. It expands the scope of this Article to cover agricultural liens, as defined in Section 9-102.

4. **Sales of Accounts, Chattel Paper, Payment Intangibles, Promissory Notes, and Other Receivables.** Under subsection (a)(3), as under former Section 9-102, this Article applies to sales of accounts and chattel paper. This approach generally has been successful in avoiding difficult problems of distinguishing between transactions in which a receivable secures an obligation and those in which the receivable has been sold outright. In many commercial financing transactions the distinction is blurred.

Subsection (a)(3) expands the scope of this Article by including the sale of a "payment intangible" (defined in Section 9-102 as "a general intangible under which the account debtor's principal obligation is a monetary obligation") and a "promissory note" (also defined in Section 9-102). To a considerable extent, this Article affords these transactions treatment identical to that given sales of accounts and chattel paper. In some respects, however, sales of payment intangibles and promissory notes are treated differently from sales of other receivables. See, e.g., Sections 9-309 (automatic perfection upon attachment), 9-408 (effect of restrictions on assignment). By virtue of the expanded definition of "account" (defined in Section 9-102), this Article now covers sales of (and other security interests in) "health-care-insurance receiv-

ables" (also defined in Section 9-102). Although this Article occasionally distinguishes between outright sales of receivables and sales that secure an obligation, neither this Article nor the definition of "security interest" (Section 1-201(37)) delineates how a particular transaction is to be classified. That issue is left to the courts.

5. **Transfer of Ownership in Sales of Receivables.** A "sale" of an account, chattel paper, a promissory note, or a payment intangible includes a sale of a right in the receivable, such as a sale of a participation interest. The term also includes the sale of an enforcement right. For example, a "[p]erson entitled to enforce" a negotiable promissory note (Section 3-301) may sell its ownership rights in the instrument. See Section 3-203, Comment 1 ("Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3, which do not depend upon whether the instrument was transferred under Section 3-203."). Also, the right under Section 3-309 to enforce a lost, destroyed, or stolen negotiable promissory note may be sold to a purchaser who could enforce that right by causing the seller to provide the proof required under that section. This Article rejects decisions reaching a contrary result, e.g., *Dennis Joslin Co. v. Robinson Broadcasting,* 977 F. Supp. 491 (D.D.C. 1997).

Nothing in this section or any other provision of Article 9 prevents the transfer of full and complete ownership of an account, chattel paper, an instrument, or a payment intangible in a transaction of sale. However, as mentioned in Comment 4, neither this Article nor the definition of "security interest" in Section 1-201 provides rules for distinguishing sales transactions from those that create a security interest securing an obligation. This Article applies to both types of transactions. The principal effect of this coverage is to apply this Article's perfection and priority rules to these sales transactions. Use of terminology such as "security interest," "debtor," and "collateral" is merely a drafting convention adopted to reach this end, and its use has no relevance to distinguishing sales from other transactions. See PEB Commentary No. 14.

Following a debtor's outright sale and transfer of ownership of a receivable, the debtor-seller retains no legal or equitable rights in the receivable that has been sold. See Section 9-318(a). This is so whether or not the buyer's security interest is perfected. (A security interest arising from the sale of a promissory note or payment intangible is perfected upon attachment without further action. See Section 9-309.) However, if the buyer's interest in accounts or chattel paper is unperfected, a subsequent lien creditor, perfected secured party, or qualified buyer can reach the sold receivable and achieve priority over (or take free of) the buyer's unperfected security interest under Section 9-317. This is so not because the seller of a receivable retains rights in the property sold; it does not. Nor is this so because the seller of a receivable is a "debtor" and the buyer of a receivable is a "secured party" under this Article (they are). It is so for the simple reason that Sections 9-318(b), 9-317, and 9-322 make it so, as did former Sections 9-301 and 9-312. Because the buyer's security interest is unperfected, for purposes of determining the rights of creditors of and purchasers for value from the debtor-seller, under Section 9-318(b) the debtor-seller is deemed to have the rights and title it sold. Section 9-317 subjects the buyer's unperfected interest in accounts and chattel paper to that of the debtor-seller's lien creditor and other persons who qualify under that section.

6. **Consignments.** Subsection (a)(4) is new. This Article applies to every "consignment." The term, defined in Section 9-102, includes many but not all "true" consignments (i.e., bailments for the purpose of sale). If a transaction is a "sale or return," as defined in revised Section 2-326, it is not a "consignment." In a "sale or return" transaction, the buyer becomes the owner of the goods, and the seller may obtain an enforceable security interest in the goods only by satisfying the requirements of Section 9-203.

Under common law, creditors of a bailee were unable to reach the interest of the bailor (in the case of a consignment, the consignor-owner). Like former Section 2-326 and former Article 9, this Article changes the common-law result; however, it does so in a different manner. For purposes of determining the rights and interests of third-party creditors of, and purchasers of the goods from, the consignee, but not for other purposes, such as remedies of the consignor, the consignee is deemed to acquire under this Article whatever rights and title the consignor had or had power to transfer. See Section 9-319. The interest of a consignor is defined to be a security interest under revised Section 1-201(37), more specifically, a purchase-money security interest in the consignee's inventory. See Section 9-103(d). Thus, the rules pertaining to lien creditors, buyers, and attachment, perfection, and priority of competing security interests apply to consigned goods. The relationship between the consignor and consignee is left to other law. Consignors also have no duties under Part 6. See Section 9-601(g).

Sometimes parties characterize transactions that secure an obligation (other than the bailee's obligation to returned bailed goods) as "consignments." These transactions are not "consignments" as contemplated by Section 9-109(a)(4). See Section 9-102. This Article applies also to these transactions, by virtue of Section 9-109(a)(1). They create a security in-

terest within the meaning of the first sentence of Section 1-201(37).

This Article does not apply to bailments for sale that fall outside the definition of "consignment" in Section 9-102 and that do not create a security interest that secures an obligation.

7. **Security Interest in Obligation Secured by Non-Article 9 Transaction.** Subsection (b) is unchanged in substance from former Section 9-102(3). The following example provides an illustration.

Example 1: O borrows $10,000 from M and secures its repayment obligation, evidenced by a promissory note, by granting to M a mortgage on O's land. This Article does not apply to the creation of the real-property mortgage. However, if M sells the promissory note to X or gives a security interest in the note to secure M's own obligation to X, this Article applies to the security interest thereby created in favor of X. The security interest in the promissory note is covered by this Article even though the note is secured by a real-property mortgage. Also, X's security interest in the note gives X an attached security interest in the mortgage lien that secures the note and, if the security interest in the note is perfected, the security interest in the mortgage lien likewise is perfected. See Sections 9-203, 9-308.

It also follows from subsection (b) that an attempt to obtain or perfect a security interest in a secured obligation by complying with non-Article 9 law, as by an assignment of record of a real-property mortgage, would be ineffective. Finally, it is implicit from subsection (b) that one cannot obtain a security interest in a lien, such as a mortgage on real property, that is not also coupled with an equally effective security interest in the secured obligation. This Article rejects cases such as In re *Maryville Savings & Loan Corp.*, 743 F.2d 413 (6th Cir. 1984), clarified on reconsideration, 760 F.2d 119 (1985).

8. **Federal Preemption.** Former Section 9-104(a) excluded from Article 9 "a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property." Some (erroneously) read the former section to suggest that Article 9 sometimes deferred to federal law even when federal law did not preempt Article 9. Subsection (c)(1) recognizes explicitly that this Article defers to federal law only when and to the extent that it must i.e., when federal law preempts it.

9. **Governmental Debtors.** Former Section 9-104(e) excluded transfers by governmental debtors. It has been revised and replaced by the exclusions in new paragraphs (2) and (3) of subsection (c). These paragraphs reflect the view that Article 9 should apply to security interests created by a State, foreign country, or a "governmental unit" (defined in Section 9-102) of either except to the extent that another statute governs the issue in question. Under paragraph (2), this Article defers to all statutes of the forum State. (A forum cannot determine whether it should consult the choice-of-law rules in the forum's UCC unless it first determines that its UCC applies to the transaction before it.) Paragraph (3) defers to statutes of another State or a foreign country only to the extent that those statutes contain rules applicable specifically to security interests created by the governmental unit in question.

Example 2: A New Jersey state commission creates a security interest in favor of a New York bank. The validity of the security interest is litigated in New York. The relevant security agreement provides that it is governed by New York law. To the extent that a New Jersey statute contains rules peculiar to creation of security interests by governmental units generally, to creation of security interests by state commissions, or to creation of security interests by this particular state commission, then that law will govern. On the other hand, to the extent that New Jersey law provides that security interests created by governmental units, state commissions, or this state commission are governed by the law generally applicable to secured transactions (i.e., New Jersey's Article 9), then New York's Article 9 will govern.

Example 3: An airline that is an instrumentality of a foreign country creates a security interest in favor of a New York bank. The analysis used in the previous example would apply here. That is, if the matter is litigated in New York, New York law would govern except to the extent that the foreign country enacted a statute applicable to security interests created by governmental units generally or by the airline specifically.

The fact that New York law applies does not necessarily mean that perfection is accomplished by filing in New York. Rather, it means that the court should apply New York's Article 9, including its choice-of-law provisions. Under New York's Section 9-301, perfection is governed by the law of the jurisdiction in which the debtor is located. Section 9-307 determines the debtor's location for choice-of-law purposes.

If a transaction does not bear an appropriate relation to the forum State, then that State's Article 9 will not apply, regardless of whether the transaction would be excluded by paragraph (3).

Example 4: A Belgian governmental unit grants a security interest in its equipment to a Swiss secured party. The equipment is located in Belgium. A dispute arises and, for some reason, an action is brought in a New Mexico state court. Inasmuch as the transaction bears no "appropriate relation" to New Mexico, New Mexico's UCC, including its Article 9, is inapplicable. See Section 1-105(1). New Mexico's

Section 9-109(c) on excluded transactions should not come into play. Even if the parties agreed that New Mexico law would govern, the parties' agreement would not be effective because the transaction does not bear a "reasonable relation" to New Mexico. See Section 1-105(1).

Conversely, Article 9 will come into play only if the litigation arises in a UCC jurisdiction or if a foreign choice-of-law rule leads a foreign court to apply the law of a UCC jurisdiction. For example, if issues concerning a security interest granted by a foreign airline to a New York bank are litigated overseas, the court may be bound to apply the law of the debtor's jurisdiction and not New York's Article 9.

10. **Certain Statutory and Common-Law Liens; Interests in Real Property.** With few exceptions (nonconsensual agricultural liens being one), this Article applies only to consensual security interests in personal property. Following former Section 9-104(b) and (j), paragraphs (1) and (11) of subsection (d) exclude landlord's liens and leases and most other interests in or liens on real property. These exclusions generally reiterate the limitations on coverage (i.e., "by contract," "in personal property and fixtures") made explicit in subsection (a)(1). Similarly, most jurisdictions provide special liens to suppliers of many types of services and materials, either by statute or by common law. With the exception of agricultural liens, it is not necessary for this Article to provide general codification of this lien structure, which is determined in large part by local conditions and which is far removed from ordinary commercial financing. As under former Section 9- 104(c), subsection (d)(2) excludes these suppliers' liens (other than agricultural liens) from this Article. However, Section 9-333 provides a rule for determining priorities between certain possessory suppliers' liens and security interests covered by this Article.

11. **Wage and Similar Claims.** As under former Section 9-104(d), subsection (d)(3) excludes assignments of claims for wages and the like from this Article. These assignments present important social issues that other law addresses. The Federal Trade Commission has ruled that, with some exceptions, the taking of an assignment of wages or other earnings is an unfair act or practice under the Federal Trade Commission Act. See 16 C.F.R. Part 444. State statutes also may regulate such assignments.

12. **Certain Sales and Assignments of Receivables; Judgments.** In general this Article covers security interests in (including sales of) accounts, chattel paper, payment intangibles, and promissory notes. Paragraphs (4), (5), (6), and (7) of subsection (d) exclude from the Article certain sales and assignments of receivables that, by their nature, do not concern commercial financing transactions. These paragraphs add to the exclusions in former Section 9-104(f) analogous sales and assignments of payment intangibles and promissory notes. For similar reasons, subsection (d)(9) retains the exclusion of assignments of judgments under former Section 9-104(h) (other than judgments taken on a right to payment that itself was collateral under this Article).

13. **Insurance.** Subsection (d)(8) narrows somewhat the broad exclusion of interests in insurance policies under former Section 9-104(g). This Article now covers assignments by or to a health-care provider of "health-care-insurance receivables" (defined in Section 9-102).

14. **Set-Off.** Subsection (d)(10) adds two exceptions to the general exclusion of set-off rights from Article 9 under former Section 9-104(i). The first takes account of new Section 9-340, which regulates the effectiveness of a set-off against a deposit account that stands as collateral. The second recognizes Section 9-404, which affords the obligor on an account, chattel paper, or general intangible the right to raise claims and defenses against an assignee (secured party).

15. **Tort Claims.** Subsection (d)(12) narrows somewhat the broad exclusion of transfers of tort claims under former Section 9-104(k). This Article now applies to assignments of "commercial tort claims" (defined in Section 9-102) as well as to security interests in tort claims that constitute proceeds of other collateral (e.g., a right to payment for negligent destruction of the debtor's inventory). Note that once a claim arising in tort has been settled and reduced to a contractual obligation to pay, the right to payment becomes a payment intangible and ceases to be a claim arising in tort.

This Article contains two special rules governing creation of a security interest in tort claims. First, a description of collateral in a security agreement as "all tort claims" is insufficient to meet the requirement for attachment. See Section 9-108(e). Second, no security interest attaches under an after-acquired property clause to a tort claim. See Section 9-204(b). In addition, this Article does not determine whom the tortfeasor must pay to discharge its obligation. Inasmuch as a tortfeasor is not an "account debtor," the rules governing waiver of defenses and discharge of an obligation by an obligor (Sections 9-403, 9-404, 9-405, and 9-406) are inapplicable to tort-claim collateral.

16. **Deposit Accounts.** Except in consumer transactions, deposit accounts may be taken as original collateral under this Article. Under former Section 9-104(l), deposit accounts were excluded as original collateral, leaving security interests in deposit accounts to be governed by the common law. The common law is nonuniform, often difficult to discover and comprehend, and frequently costly to implement. As a

consequence, debtors who wished to use deposit accounts as collateral sometimes were precluded from doing so as a practical matter. By excluding deposit accounts from the Article's scope as original collateral in consumer transactions, subsection (d)(13) leaves those transactions to law other than this Article. However, in both consumer and non-consumer transactions, sections 9-315 and 9-322 apply to deposit accounts as proceeds and with respect to priorities in proceeds.

This Article contains several safeguards to protect debtors against inadvertently encumbering deposit accounts and to reduce the likelihood that a secured party will realize a windfall from a debtor's deposit accounts. For example, because "deposit account" is a separate type of collateral, a security agreement covering general intangibles will not adequately describe deposit accounts. Rather, a security agreement must reasonably identify the deposit accounts that are the subject of a security interest, e.g., by using the term "deposit accounts." See Section 9-108. To perfect a security interest in a deposit account as original collateral, a secured party (other than the bank with which the deposit account is maintained) must obtain "control" of the account either by obtaining the bank's authenticated agreement or by becoming the bank's customer with respect to the deposit account. See Sections 9-312(b)(1), 9-104. Either of these steps requires the debtor's consent.

This Article also contains new rules that determine which State's law governs perfection and priority of a security interest in a deposit account (Section 9-304), priority of conflicting security interests in and set-off rights against a deposit account (Sections 9-327, 9-340), the rights of transferees of funds from an encumbered deposit account (Section 9-332), the obligations of the bank (Section 9-341), enforcement of security interests in a deposit account (Section 9-607(c)), and the duty of a secured party to terminate control of a deposit account (Section 9-208(b)).

ANNOTATION

Law reviews. For comment on Ware v. Barr appearing below, see 25 Rocky Mt. L. Rev. 98 (1952). For comment on Exch. Nat'l Bank v. Hough appearing below, see 31 Rocky Mt. L. Rev. 232 (1959). For note, "Filing Under the Uniform Commercial Code Act 9", see 38 U. Colo. L. Rev. 598 (1966). For comment on Rosenthal v. Whitehead appearing below, see 39 U. Colo. L. Rev. 167 (1966). For note, "The Landlord's Lien in Colorado Practice and Under the Bankruptcy Act", see 40 U. Colo. L. Rev. 402 (1968). For article, "The Rights of Landlords in Tenants' Personal Property", see 57 Den. L.J. 685 (1980). For article "Commercial Law", see 59 Den. L.J. 227 (1982). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Setoff and Security Interests In Deposit Accounts", see 17 Colo. Law. 2108 (1988). For article, "Mastering the Maze of Secured Transactions - Part 1", see 21 Colo. Law. 2329 (1992).

Annotator's note. Since § 4-9-109 is similar to §§ 4-9-102 and 4-9-104 as they existed prior to the 2001 repeal and reenactment of this article, relevant cases construing those provisions have been included in the annotations to this section.

The law pertaining to the assignment of contract rights is set forth in this section. Farmers Acceptance Corp. v. DeLozier, 178 Colo. 291, 496 P.2d 1016 (1972).

A court cannot through ancillary proceedings place a judgment creditor in a better or more favorable position than he would be in if levy were made upon the property. Hilst v. Bennett, 175 Colo. 78, 485 P.2d 880 (1971).

A court cannot require posting of bond. In ancillary proceedings in aid of execution on a judgment there is no jurisdiction in the courts to require a creditor to post a bond to secure payment of the judgment. Hilst v. Bennett, 175 Colo. 78, 485 P.2d 880 (1971).

For cases which construe provisions prior to U.C.C. concerning chattel mortgages, see Machette v. Wanless, 1 Colo. 225 (1870); Machette v. Wanless, 2 Colo. 169 (1873); Chapin v. Whitsett, 3 Colo. 315 (1877); Crane v. Chandler, 5 Colo. 21 (1879); George v. Tufts, 5 Colo. 162 (1879); Horner v. Stout, 5 Colo. 166 (1879); Cook v. Mann, 6 Colo. 21 (1881); Tabor v. Sampson, 7 Colo. 426, 4 P. 45 (1884); Wilcox v. Jackson, 7 Colo. 521, 4 P. 966 (1884); Frank v. Denver & R.G. Ry., 23 F. 123 (D. Colo. 1885); Wilson v. Voight, 9 Colo. 614, 13 P. 726 (1886); Brasher v. Christophe, 10 Colo. 284, 15 P. 403 (1887); Gerow v. Castello, 11 Colo. 560, 19 P. 505 (1888); Atchison v. Graham, 14 Colo. 217, 23 P. 876 (1890); Harbison v. Tufts, 1 Colo. App. 140, 27 P. 1014 (1891); Newman v. People ex rel. McHenry, 4 Colo. App. 46, 34 P. 1006 (1893); Foster v. Cramer, 19 Colo. 405, 35 P. 747 (1894); Colo. Sav. Bank v. Metro. Theater Co., 20 Colo. 313, 36 P. 902 (1894); Jones v. Clark, 20 Colo. 353, 38 P. 371 (1894); Roberts v. Johnson, 5 Colo. App. 406, 39 P. 596 (1895); Citizens' Coal & Coke Co. v. Stanley, 6 Colo. App. 181, 40 P. 693 (1895); Bank v. Hastings, 7 Colo. App. 129, 42 P. 691 (1895); Edinger v. Grace, 8 Colo. App. 21, 44 P. 855 (1896); Mumford v. Harris, 8 Colo. App. 51, 44 P. 772 (1896); Stanley v. Citizens' Coal & Coke Co., 24 Colo. 103, 49 P. 35 (1897); Burchinell v. Gorsline, 11 Colo. App. 22, 52 P. 413 (1898);

Crocker v. Burns, 13 Colo. App. 54, 56 P. 199 (1899); Nichols v. Chittenden, 14 Colo. App. 49, 59 P. 954 (1899); First Congregational Church v. Grand Rapids Sch. Furn. Co., 15 Colo. App. 46, 60 P. 948 (1900); McGovney v. Gwillin, 16 Colo. App. 284, 65 P. 346 (1901); Morse v. Morrison, 16 Colo. App. 449, 66 P. 169 (1901); Clark v. Bright, 30 Colo. 199, 69 P. 506 (1902); Richardson v. Longmont Supply Ditch Co., 19 Colo. App. 483, 76 P. 546 (1904); Fischback v. Garrison Milling & Elevator Co., 20 Colo. App. 448, 79 P. 749 (1905); Cassell v. Deisher, 39 Colo. 367, 89 P. 773 (1907); Klug v. Munce, 40 Colo. 276, 90 P. 603 (1907); Street v. Sederburg, 41 Colo. 128, 92 P. 29 (1907); Hurt v. Hubbard, 41 Colo. 505, 92 P. 908 (1907); Simonson v. McHenry, 41 Colo. 508, 92 P. 906 (1907); Sigel-Campion Live Stock Comm'n Co. v. Holly, 44 Colo. 580, 101 P. 68 (1908); Fischbach v. Garrison Milling & Elevator Co., 46 Colo. 29, 102 P. 895 (1909); Bradford v. Roberts, 46 Colo. 330, 104 P. 391 (1909); Babbitt v. Bent County Bank, 50 Colo. 258, 108 P. 1003 (1911); Owen v. Owens, 51 Colo. 93, 117 P. 134 (1911); Stumpff v. People, 51 Colo. 202, 117 P. 134 (1911); Ferris v. Chambers, 51 Colo. 368, 117 P. 994 (1911); Meador v. Cullison, 52 Colo. 172, 120 P. 145 (1911); Puzzle Mining & Reduction Co. v. Morse Bros. Mach. & Supply Co., 24 Colo. App. 74, 131 P. 791 (1913); Ellison v. Tuckerman, 24 Colo. App. 322, 134 P. 163 (1913); Booth v. Central Sav. Bank, 58 Colo. 519, 146 P. 240 (1915); Stitt v. Spengel House Furnishing Co., 58 Colo. 559, 146 P. 770 (1915); Sorrells v. Sigel-Campion Live Stock Comm'n Co., 27 Colo. App. 154, 148 P. 279 (1915); Thompson v. Rowe, 27 Colo. App. 361, 149 P. 849 (1915); Brown v. People, 61 Colo. 27, 155 P. 332 (1916); First Nat'l Bank v. Felter, 65 Colo. 370, 176 P. 496 (1918); Beatrice Creamery Co. v. Sylvester, 65 Colo. 569, 174 P. 154 (1919); J. D. Best & Co. v. Wolf Co., 67 Colo. 42, 185 P. 371 (1919); Strauss v. Austgen, 67 Colo. 207, 184 P. 299 (1919); Cobb v. Int'l. State Bank, 67 Colo. 488, 186 P. 529 (1919); Cobb v. Aiello, 67 Colo. 533, 186 P. 531 (1919); Lampman v. Lamping, 70 Colo. 167, 199 P. 418 (1921); Littell v. Brayton Motor & Accessory Co., 70 Colo. 286, 201 P. 34 (1921); Lowdermilk v. People, 70 Colo. 459, 202 P. 118 (1921); Lewin v. Telluride Iron Works Co., 272 F. 590 (8th Cir. 1921); Turnbull v. Cole, 70 Colo. 364, 201 P. 887 (1922); Downer v. Bermingham, 71 Colo. 245, 205 P. 948 (1922); Metro. State Bank v. Wright, 72 Colo. 106, 209 P. 804 (1922); Russell v. First Nat'l Bank, 72 Colo. 312, 211 P. 372 (1922); Broadhead v. Farmers' State Bank, 72 Colo. 430, 211 P. 376 (1922); Sowards v. Jones, 75 Colo. 25, 223 P. 747 (1924); Hawkes v. First Nat'l Bank, 75 Colo. 47, 224 P. 224 (1924); Bogdon v. Fort, 75 Colo. 231, 225 P. 247 (1924); Anglo-American Mill Co. v. First Nat'l Bank, 76 Colo. 57, 230 P. 118 (1924); Welty v. Burks, 76 Colo. 365 231 P. 660 (1924); Rhodes v. Harmon, 76 Colo. 565, 231 P. 222 (1925); First Nat'l Bank v. O'Connell, 77 Colo. 275, 236 P. 1002 (1925); Walker v. Mathis, 78 Colo. 384, 242 P. 68 (1925); Radetsky v. Gramm-Bernstein Motor Truck Co., 4 F.2d 965 (8th Cir. 1925); Burroughs Adding Mach. Co. v. Bogdon, 9 F.2d 54 (8th Cir. 1925); First State Bank v. Fox, 10 F.2d 116 (8th Cir. 1925); Conrad v. Nat'l Bank, 78 Colo. 485, 242 P. 676 (1926); Wilder v. Colo. Motor Fin. Co., 79 Colo. 97, 244 P. 596 (1926); Lamon v. Harada, 80 Colo. 89, 249 P. 267 (1926); Broadbent v. McFerson 80 Colo. 264, 250 P. 852 (1926); Rocky Mt. Seed Co. v. McArthur, 85 Colo. 1, 272 P. 1117 (1928); Mosko v. Matthews, 87 Colo. 55, 284 P. 1021 (1930); McCormick v. First Nat'l Bank, 88 Colo. 599, 299 P. 7 (1931); Thimmig v. Segal, 89 Colo. 385, 3 P.2d 303 (1931); Illinois Bldg. Co. v. Patterson, 91 Colo. 391, 15 P.2d 699 (1932); Blackmer Furn. Co. v. Bingham, 92 Colo. 456, 21 P.2d 711 (1933); McMinn v. Harrison, 93 Colo. 5, 23 P.2d 944 (1933); McClain v. Saranac Mach. Co., 94 Colo. 145, 28 P.2d 1009 (1934); Conway v. Headquist, 95 Colo. 187, 34 P.2d 69 (1934); Tolland Co. v. First State Bank, 95 Colo. 321, 35 P.2d 867 (1934); Int'l. Harvester Co. v. McFerson, 95 Colo. 482, 37 P.2d 390 (1934); Schreiber v. Colt, 80 F.2d 511 (10th Cir. 1935); Prather v. Auto Indus. Corp., 96 Colo. 516, 45 P.2d 628 (1935); Stokes v. Kirk, 97 Colo. 96, 47 P.2d 686 (1935); Thomas v. First Nat'l Bank, 97 Colo. 474, 51 P.2d 589 (1935); Fisher v. Norman Apts., 101 Colo. 173, 72 P.2d 1092 (1937); Stokes v. Kirk, 101 Colo. 591, 75 P.2d 1041 (1938); Paoli State Bank v. Barker, 108 Colo. 153, 113 P.2d 1004 (1941); Crosswhite v. People, 110 Colo. 584, 137 P.2d 399 (1943); Hofmann v. Lamb, 113 Colo. 585, 160 P.2d 995 (1945); Smith v. Greenberg, 121 Colo. 417, 218 P.2d 514 (1950); Denver Motor Fin. Co. v. Stevens, 128 Colo. 531, 265 P.2d 224 (1953); Central Fin. Corp. v. Calvert, 130 Colo. 519, 276 P.2d 990 (1954); In re Clements, 120 F. Supp. 224 (D. Colo. 1954); Rabtoay Gen. Tire Co. v. Colo. Kenworth Corp., 135 Colo. 110, 309 P.2d 616 (1957); Exch. Nat'l Bank v. Hough, 258 F.2d 785 (10th Cir. 1958); In re Maldonado, 171 F. Supp. 340 (D. Colo. 1959); Bank of Denver v. Legler, 142 Colo. 333, 350 P.2d 1059 (1960); Roylance v. Citizens Sav. Bank, 148 Colo. 423, 366 P.2d 557 (1961); Allan v. Diamond T Motor Car Co., 291 F.2d 115 (10th Cir. 1961); Rosenthal v. Whitehead, 159 Colo. 565, 413 P.2d 909 (1966); McCoy v. People, 165 Colo. 407, 439 P.2d 347 (1968); Am. Nat'l Bank v. First Nat'l Bank, 28 Colo. App. 486, 476 P.2d 304 (1970); Am. Nat'l Bank v. Etter, 28 Colo. App. 511, 476 P.2d 287 (1970); Am. Nat'l Bank v. Magor, 28 Colo. App. 522, 476 P.2d 267 (1970); Crepeau v. Renewal Guar. Corp., 29 Colo. App. 23, 478 P.2d 698 (1970)

(decided under repealed §§ 21-1-1 et seq. and 21-2-1 et seq., C.R.S. 1963, §§ 20-1-1 et seq. and 20-2-1 et seq., CRS 53, CSA, C. 32, § 1 et seq., and laws antecedent to CSA, C. 32, § 1 et seq.).

For cases which construe provisions prior to U.C.C. concerning assignment of accounts receivable, see Ware v. Barr, 126 Colo. 311, 248 P.2d 1073 (1952); Rabtoay Gen. Tire Co. v. Colo. Kenworth Corp., 135 Colo. 110, 309 P.2d 616 (1957); In re Mile Hi Restaurants, Inc., 233 F. Supp. 936 (D. Colo. 1964); Rottman v. First Nat'l Bank, 401 F.2d 484 (10th Cir. 1969); Matson & Mulhausen Constr. Co. v. Boulevard Nat'l Bank, 28 Colo. App. 427, 475 P.2d 356 (1970); Crepeau v. Renewal Guar. Corp., 29 Colo. App. 23, 478 P.2d 698 (1970); McCormick v. Diamond Shamrock Corp., 175 Colo. 406, 487 P.2d 1333 (1971) (decided under repealed § 11-2-1 et seq., C.R.S. 1963, § 11-2-1 et seq., CRS 53, and CSA, C. 12A, § 1 et seq.).

Any transaction intended to create a security interest is subject to this article. Colo. Leasing Corp. v. Borquez, 738 P.2d 377 (Colo. App. 1986); Western Group Nurseries v. Pomeranz, 867 P.2d 12 (Colo. App. 1993).

A security interest may be created in numerous types of assets, including contract rights. Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977).

Right to reclaim is not a species of interest in goods which is the result of a transaction "intended to create a security interest" and is not created by contract as contemplated within the meaning of § 4-9-102. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Characterization of transaction as "lease" or "sale" is not controlling. Whether a transaction is characterized as a lease or sale is not controlling, but rather it is the intention of the parties to create a security interest which is controlling, that intention to be determined by the facts of each case. H.M.O. Sys. v. Choicecare Health Servs., Inc., 665 P.2d 635 (Colo. App. 1983).

"Lease" agreement being held is a contract of sale creating security interest. Colo. Leasing Corp. v. Borquez, 738 P.2d 377 (Colo. App. 1986).

Profits from motel business are personalty and not an interest in real property. In re M. Vickers, 110 Bankr. 332 (Bankr. D. Colo. 1990).

Security interest in automobiles do not attach until title certificates are delivered to bank. After the purchaser of some automobiles delivered its check to the seller, but before the certificates of title were transferred to a bank as the purchaser's agent, the purchaser executed a security agreement with the bank, intending to create a security interest in the automobiles to secure repayment of the bank's financing loan, until the certificates of title were properly transferred to the purchaser's agent, no right, title, or interest was created in the purchaser which would enable it to legally convey or encumber the automobiles. Therefore, although the bank and purchaser fully intended that the security interest attach to the automobiles at the time the loan funds were deposited in the purchaser's account, the absence of any legal right, title, or interest by the purchaser in the automobiles prevented the bank's security interest from attaching prior to the time that the certificates of title were delivered. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Security interests in realty paper represent a personal property right to receive payment and are governed by the UCC. Citicorp v. Fremont Nat. Bank, 738 P.2d 29 (Colo. App. 1987).

A seller's right to receive payment by virtue of an installment land sale contract is a personal property right and is governed by this article. Citicorp v. Fremont Nat. Bank, 738 P.2d 29 (Colo. App. 1987).

This article applies to the attachment and perfection of a bank's security interest in note and deed of trust which were delivered pursuant to a loan agreement, even though the deed of trust secured an interest in real estate. Jackson Co. Federal Savings v. Maduff Mortgage Corp., 608 F. Supp. 588 (D. Colo. 1985).

The governmental subdivision or agency exclusion of subsection (e) covers only transactions in which the government is a debtor/borrower. Bowlen v. Federal Deposit Insurance Corp., 815 P.2d 1013 (Colo. App. 1991).

A leasehold, although enumerated in a security agreement, is not subject to the provisions of the UCC under subsection (j). Hilst v. Bennett, 175 Colo. 78, 485 P.2d 880 (1971).

This law does not apply to creation, etc., of interest in or lien on real estate. By its very terms the UCC does not apply to the creation or transfer of an interest in or lien on real estate. Fort Collins Prod. Credit Ass'n v. Carroll Dairy, 37 Colo. App. 536, 553 P.2d 95 (1976).

The right to proceeds from an installment land sale contract constitute a security interest to be governed by this article. Citicorp v. Fremont Nat. Bank, 738 P.2d 29 (Colo. App. 1987).

A perfected interest in property cannot be displaced by subsequent attorney's lien. This section provides a first lien to attorney on property of client, but lien is subject to security interest in client's property that was perfected prior to attorney's lien. Colo. Nat. Bank v. Zerobnick & Sander, 768 P.2d 1276 (Colo. App. 1989).

Applied in Welbourne Dev. Co. v. Affiliated Clearance Corp., 28 Colo. App. 313, 472 P.2d 684 (1970); Rocky Mt. Ass'n of Credit Mgt. v.

Hessler Mfg. Co., 37 Colo. App. 551, 553 P.2d 840 (1976); Bd. of County Comm'rs v. Berkeley Vill., 40 Colo. App. 431, 580 P.2d 1251 (1978); James v. Ford Motor Credit Co., 638 F.2d 147 (10th Cir. 1980); Jackson v. Security Indus. Bank, 4 Bankr. 293 (Bankr. D. Colo. 1980); Swofford v. Colo. Nat'l Bank, 628 P.2d 184 (Colo. App. 1981); Wiley v. Bank of Fountain Valley, 632 P.2d 282 (Colo. App. 1981); Young v. Golden State Bank, 632 P.2d 1053 (Colo. App. 1981); ITT Diversified Credit Corp. v. Couch, 669 P.2d 1355 (Colo. 1983).

4-9-110. Security interests arising under article 2 or 2.5. A security interest arising under section 4-2-401, 4-2-505, 4-2-711 (3), or 4-2.5-508 (5) is subject to this article. However, until the debtor obtains possession of the goods:

(1) The security interest is enforceable, even if section 4-9-203 (b) (3) has not been satisfied;

(2) Filing is not required to perfect the security interest;

(3) The rights of the secured party after default by the debtor are governed by article 2 or 2.5 of this title; and

(4) The security interest has priority over a conflicting security interest created by the debtor.

Source: L. 2001: Entire article R&RE, p. 1333, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-113 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-113.

2. **Background.** Former Section 9-113, from which this section derives, referred generally to security interests "arising solely under the Article on Sales (Article 2) or the Article on Leases (Article 2A)." Views differed as to the precise scope of that section. In contrast, Section 9-110 specifies the security interests to which it applies.

3. **Security Interests Under Articles 2 and 2A.** Section 2-505 explains how a seller of goods may reserve a security interest in them. Section 2-401 indicates that a reservation of title by the seller of goods, despite delivery to the buyer, is limited to reservation of a security interest. As did former Article 9, this Article governs a security interest arising solely under one of those sections; however, until the buyer obtains possession of the goods, the security interest is enforceable even in the absence of a security agreement, filing is not necessary to perfect the security interest, and the seller-secured party's rights on the buyer's default are governed by Article 2.

Sections 2-711(3) and 2A-508(5) create a security interest in favor of a buyer or lessee in possession of goods that were rightfully rejected or as to which acceptance was justifiably revoked. As did former Article 9, this Article governs a security interest arising solely under one of those sections; however, until the seller or lessor obtains possession of the goods, the security interest is enforceable even in the absence of a security agreement, filing is not necessary to perfect the security interest, and the secured party's (buyer's or lessee's) rights on the debtor's (seller's or lessor's) default are governed by Article 2 or 2A, as the case may be.

4. **Priority.** This section adds to former Section 9-113 a priority rule. Until the debtor obtains possession of the goods, a security interest arising under one of the specified sections of Article 2 or 2A has priority over conflicting security interests created by the debtor. Thus, a security interest arising under Section 2-401 or 2-505 has priority over a conflicting security interest in the buyer's after-acquired goods, even if the goods in question are inventory. Arguably, the same result would obtain under Section 9-322, but even if it would not, a purchase-money-like priority is appropriate. Similarly, a security interest under Section 2-711(3) or 2A-508(5) has priority over security interests claimed by the seller's or lessor's secured lender. This result is appropriate, inasmuch as the payments giving rise to the debt secured by the Article 2 or 2A security interest are likely to be included among the lender's proceeds.

Example: Seller owns equipment subject to a security interest created by Seller in favor of Lender. Buyer pays for the equipment, accepts the goods, and then justifiably revokes acceptance. As long as Seller does not recover possession of the equipment, Buyer's security interest under Section 2-711(3) is senior to that of Lender.

In the event that a security interest referred to in this section conflicts with a security interest that is created by a person other than the debtor, Section 9-325 applies. Thus, if Lender's security interest in the example was created not by Seller but by the person from whom Seller acquired the goods, Section 9-325 would govern.

5. **Relationship to Other Rights and Remedies Under Articles 2 and 2A.** This Article does not specifically address the conflict between (i) a security interest created by a buyer or lessee and (ii) the seller's or lessor's right to withhold delivery under Section 2-702(1), 2-703(a), or 2A-525, the seller's or lessor's right to stop delivery under Section 2-705 or 2A-526, or the seller's right to reclaim under Section 2-507(2) or 2-702(2). These conflicts are governed by the first sentence of Section 2-403(1), under which the buyer's secured party obtains no greater rights in the goods than the buyer had or had power to convey, or Section 2A-307(1), under which creditors of the lessee take subject to the lease contract.

ANNOTATION

Annotator's note. Since § 4-9-110 is similar to § 4-9-113 as it existed prior to the 2001 repeal and reenactment of this article, a relevant case construing that provision has been included in the annotations to this section.

Lessor has no security interest in extracted gravel remaining on leased premises. The owner of a gravel pit who executes a lease allowing the extraction of gravel from his pit does not have a security interest in extracted gravel remaining on the leased premises after the right to extract gravel is terminated. The lessee acquires possession of the gravel once it is extracted. Palmer v. Corey (In re Musick Constr., Inc.), 34 Bankr. 105 (Bankr. D. Colo. 1983).

PART 2

EFFECTIVENESS OF SECURITY AGREEMENT; ATTACHMENT OF SECURITY INTEREST; RIGHTS OF PARTIES TO SECURITY AGREEMENT

4-9-201. General effectiveness of security agreement. (a) Except as otherwise provided by this title, a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.

(b) A transaction subject to this article is subject to any applicable rule of law that establishes a different rule for consumers and any other statute or regulation of this state that regulates the rates, charges, agreements, and practices for loans, credit sales, or other extensions of credit and any consumer protection statute or regulation of this state, including, but not limited to, the "Uniform Consumer Credit Code", articles 1 to 9 of title 5, C.R.S., the "Colorado Consumer Protection Act", article 1 of title 6, C.R.S., "assignment of wages", article 9 of title 8, C.R.S., "property and earnings exempt", article 54 of title 13, C.R.S., and the "Colorado Fair Debt Collection Practices Act", article 14 of title 12, C.R.S.

(c) In case of conflict between this article and a rule of law, statute, or regulation described in subsection (b) of this section, the rule of law, statute, or regulation controls. Failure to comply with a statute or regulation described in subsection (b) of this section has only the effect the statute or regulation specifies.

(d) This article does not:

(1) Validate any rate, charge, agreement, or practice that violates a rule of law, statute, or regulation described in subsection (b) of this section; or

(2) Extend the application of the rule of law, statute, or regulation to a transaction not otherwise subject to it.

Source: L. 2001: Entire article R&RE, p. 1334, § 1, effective July 1. **L. 2002:** (b) and (c) amended, p. 937, § 2, effective August 7.

Editor's note: (1) The provisions of this section are similar to former §§ 4-9-201 and 4-9-203 (4) as they existed prior to 2001.

(2) **Colorado legislative change:** Colorado did not adopt the phrase "rule of law" in subsections (b) and (c) in 2001 when this article was repealed and reenacted. The phrase was subsequently adopted in 2002.

OFFICIAL COMMENT

1. **Source.** Former Sections 9-201, 9-203(4).

2. **Effectiveness of Security Agreement.** Subsection (a) provides that a security agreement is generally effective. With certain exceptions, a security agreement is effective between the debtor and secured party and is likewise effective against third parties. Note that "security agreement" is used here (and elsewhere in this Article) as it is defined in Section 9-102: "an agreement that creates or provides for a security interest." It follows that subsection (a) does not provide that every term or provision contained in a record that contains a security agreement or that is so labeled is effective. Properly read, former Section 9-201 was to the same effect. Exceptions to the general rule of subsection (a) arise where there is an overriding provision in this Article or any other Article of the UCC. For example, Section 9-317 subordinates unperfected security interests to lien creditors and certain buyers, and several provisions in Part 3 subordinate some security interests to other security interests and interests of purchasers.

3. **Law, Statutes, and Regulations Applicable to Certain Transactions.** Subsection (b) makes clear that certain transactions, although subject to this Article, also are subject to other applicable laws relating to consumers or specified in that subsection. Subsection (c) provides that the other law is controlling in the event of a conflict, and that a violation of other law does not *ipso facto* constitute a violation of this Article. Subsection (d) provides that this Article does not validate violations under or extend the application of the other applicable laws.

ANNOTATION

Law reviews. For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968).

Annotator's note. Since § 4-9-201 is similar to §§ 4-9-201 and 4-9-203 as they existed prior to the 2001 repeal and reenactment of this article, relevant cases construing those provisions have been included in the annotations to this section.

Security agreement is effective between parties except as specifically provided. It is the policy of the UCC that a security agreement shall be effective between the parties and against other parties except as specifically provided otherwise in the code. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 32 Colo. App. 235, 511 P.2d 912 (1973), aff'd, 184 Colo. 166, 519 P.2d 354 (1974).

Judicial lien takes priority. A perfected security interest securing an obligation that was undertaken by debtor before creation of a judicial lien took priority over the lien even if such obligation did not become due until after the lien's creation. Alling v. Am. Tool and Grinding Co., Inc., 648 F. Supp. 1344 (D. Colo. 1986).

Extension of security agreement to include additional amounts need not adhere to any particular form where the original agreement or indenture is valid and does not prescribe any particular form for extension agreements. The extension agreement operates as a modification of the original note amount. Vance v. Casebolt, 841 P.2d 394 (Colo. App. 1992).

There is an inconsistency between this section and former § 4-9-306 on subject of proceeds. Fort Collins Prod. Credit Ass'n v. Carroll Dairy, 37 Colo. App. 536, 553 P.2d 95 (1976) (decided prior to the 1977 amendment of this section and § 4-9-306).

Applied in Young v. Golden State Bank, 632 P.2d 1053 (Colo. App. 1981); Layne v. Fort Carson Nat'l Bank, 655 P.2d 856 (Colo. App. 1982); ITT Diversified Credit Corp. v. Couch, 669 P.2d 1355 (Colo. 1983); Bank of Am. v. Denver Hotel Ass'n, 830 P.2d 1138 (Colo. App. 1992).

4-9-202. Title to collateral immaterial. Except as otherwise provided with respect to consignments or sales of accounts, chattel paper, payment intangibles, or promissory notes, the provisions of this article with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor.

Source: L. 2001: Entire article R&RE, p. 1334, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-202 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-202.

2. **Title Immaterial.** The rights and duties of parties to a secured transaction and affected third parties are provided in this Article without reference to the location of "title" to the collateral. For example, the characteristics of a security interest that secures the purchase price of goods are the same whether the secured party appears to have retained title or the debtor appears to have obtained title and then conveyed title or a lien to the secured party.

3. **When Title Matters.**

a. **Under This Article.** This section explicitly acknowledges two circumstances in which the effect of certain Article 9 provisions turns on ownership (title). First, in some respects sales of accounts, chattel paper, payment intangibles, and promissory notes receive special treatment. See, e.g., Sections 9-207(a), 9-210(b), 9-615(e). Buyers of receivables under former Article 9 were treated specially, as well. See, e.g., former Section 9-502(2). Second, the remedies of a consignor under a true consignment and, for the most part, the remedies of a buyer of accounts, chattel paper, payment intangibles, or promissory notes are determined by other law and not by Part 6. See Section 9-601(g).

b. **Under Other Law.** This Article does not determine which line of interpretation (e.g., title theory or lien theory, retained title or conveyed title) should be followed in cases in which the applicability of another rule of law depends upon who has title. If, for example, a revenue law imposes a tax on the "legal" owner of goods or if a corporation law makes a vote of the stockholders prerequisite to a corporation "giving" a security interest but not if it acquires property "subject" to a security interest, this Article does not attempt to define whether the secured party is a "legal" owner or whether the transaction "gives" a security interest for the purpose of such laws. Other rules of law or the agreement of the parties determines the location and source of title for those purposes.

ANNOTATION

Annotator's note. The following annotations include a case decided under this section as it existed prior to its 2001 repeal and reenactment.

Failure to deliver bill of sale after giving buyer possession of assets is considered a reservation. Where plaintiffs' testimony revealed that it was their intent to sell the business and its assets to the buyer, the failure to deliver the bill of sale after giving the buyer possession of the assets was, at most, a reservation of title, and as such acted as a reservation of a security interest in the property. Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977).

4-9-203. Attachment and enforceability of security interest; proceeds; supporting obligations; formal requisites. (a) A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment.

(b) Except as otherwise provided in subsections (c) to (i) of this section, a security interest is enforceable against the debtor and third parties with respect to the collateral only if:

(1) Value has been given;

(2) The debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and

(3) One of the following conditions is met:

(A) The debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;

(B) The collateral is not a certificated security and is in the possession of the secured party under section 4-9-313 pursuant to the debtor's security agreement;

(C) The collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under section 4-8-301 pursuant to the debtor's security agreement; or

(D) The collateral is deposit accounts, electronic chattel paper, investment property, letter-of-credit rights, or electronic documents, and the secured party has control under section 4-7-106, 4-9-104, 4-9-105, 4-9-106, or 4-9-107 pursuant to the debtor's security agreement.

(c) Subsection (b) of this section is subject to section 4-4-210 on the security interest of a collecting bank, section 4-5-117.5 on the security interest of a letter-of-credit issuer or

nominated person, section 4-9-110 on a security interest arising under article 2 or 2.5 of this title, and section 4-9-206 on security interests in investment property.

(d) A person becomes bound as debtor by a security agreement entered into by another person if, by operation of law other than this article or by contract:

(1) The security agreement becomes effective to create a security interest in the person's property; or

(2) The person becomes generally obligated for the obligations of the other person, including the obligation secured under the security agreement, and acquires or succeeds to all or substantially all of the assets of the other person.

(e) If a new debtor becomes bound as debtor by a security agreement entered into by another person:

(1) The agreement satisfies paragraph (3) of subsection (b) of this section with respect to existing or after-acquired property of the new debtor to the extent the property is described in the agreement; and

(2) Another agreement is not necessary to make a security interest in the property enforceable.

(f) The attachment of a security interest in collateral gives the secured party the rights to proceeds provided by section 4-9-315 and is also attachment of a security interest in a supporting obligation for the collateral.

(g) The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien.

(h) The attachment of a security interest in a securities account is also attachment of a security interest in the security entitlements carried in the securities account.

(i) The attachment of a security interest in a commodity account is also attachment of a security interest in the commodity contracts carried in the commodity account.

(j) No security interest in consumer goods owned by a married person and used primarily for personal, family, or household purposes, other than property referred to in section 4-9-311 and other than any purchase money security interest, shall be enforceable unless the security agreement describing the collateral in accordance with section 4-9-108 is authenticated by both husband and wife if they are residing together at the time the security interest is created.

Source: L. 2001: Entire article R&RE, p. 1334, § 1, effective July 1. **L. 2006:** (b)(3)(D) amended, p. 500, § 34, effective September 1.

Editor's note: (1) The provisions of this section are similar to provisions of several former sections as they existed prior to 2001. For a detailed comparison, see the comparative tables located in the back of the index.

(2) **Colorado legislative change:** Colorado added a new subsection (j).

OFFICIAL COMMENT

1. **Source.** Former Sections 9-203, 9-115(2), (6).

2. **Creation, Attachment, and Enforceability.** Subsection (a) states the general rule that a security interest attaches to collateral only when it becomes enforceable against the debtor. Subsection (b) specifies the circumstances under which a security interest becomes enforceable. Subsection (b) states three basic prerequisites to the existence of a security interest: value (paragraph (1)), rights or power to transfer rights in collateral (paragraph (2)), and agreement plus satisfaction of an evidentiary requirement (paragraph (3)). When all of these elements exist, a security interest becomes enforceable between the parties and attaches under subsection (a). Subsection (c) identifies certain exceptions to the general rule of subsection (b).

3. **Security Agreement; Authentication.** Under subsection (b)(3), enforceability requires the debtor's security agreement and compliance with an evidentiary requirement in the nature of a Statute of Frauds. Paragraph (3)(A) represents the most basic of the evidentiary alternatives, under which the debtor must authenticate a security agreement that provides a description of the collateral. Under Section 9-102, a "security agreement" is "an agreement that creates or provides for a security interest." Neither that definition nor the requirement of paragraph (3)(A) rejects the deeply rooted doctrine that a bill of sale, although absolute in form, may be

shown in fact to have been given as security. Under this Article, as under prior law, a debtor may show by parol evidence that a transfer purporting to be absolute was in fact for security. Similarly, a self-styled "lease" may serve as a security agreement if the agreement creates a security interest. See Section 1-201(37) (distinguishing security interest from lease).

Note: "Section 1-201(37)" in the last sentence will be replaced with "Section 1-203", effective July 1, 2013.

4. **Possession, Delivery, or Control Pursuant to Security Agreement.** The other alternatives in subsection (b)(3) dispense with the requirement of an authenticated security agreement and provide alternative evidentiary tests. Under paragraph (3)(B), the secured party's possession substitutes for the debtor's authentication under paragraph (3)(A) if the secured party's possession is "pursuant to the debtor's security agreement." That phrase refers to the debtor's agreement to the secured party's possession for the purpose of creating a security interest. The phrase should not be confused with the phrase "debtor has authenticated a security agreement," used in paragraph (3)(A), which contemplates the debtor's authentication of a record. In the unlikely event that possession is obtained without the debtor's agreement, possession would not suffice as a substitute for an authenticated security agreement. However, once the security interest has become enforceable and has attached, it is not impaired by the fact that the secured party's possession is maintained without the agreement of a subsequent debtor (e.g., a transferee). Possession as contemplated by Section 9-313 is possession for purposes of subsection (b)(3)(B), even though it may not constitute possession "pursuant to the debtor's agreement" and consequently might not serve as a substitute for an authenticated security agreement under subsection (b)(3)(A). Subsection (b)(3)(C) provides that delivery of a certificated security to the secured party under Section 8-301 pursuant to the debtor's security agreement is sufficient as a substitute for an authenticated security agreement. Similarly, under subsection (b)(3)(D), control of investment property, a deposit account, electronic chattel paper, or a letter-of-credit right satisfies the evidentiary test if control is pursuant to the debtor's security agreement.

5. **Collateral Covered by Other Statute or Treaty.** One evidentiary purpose of the formal requisites stated in subsection (b) is to minimize the possibility of future disputes as to the terms of a security agreement (e.g., as to the property that stands as collateral for the obligation secured). One should distinguish the evidentiary functions of the formal requisites of attachment and enforceability (such as the requirement that a security agreement contain a description of the collateral) from the more limited goals of "notice filing" for financing statements under Part 5, explained in Section 9-502, Comment 2. When perfection is achieved by compliance with the requirements of a statute or treaty described in Section 9-311(a), such as a federal recording act or a certificate-of-title statute, the manner of describing the collateral in a registry imposed by the statute or treaty may or may not be adequate for purposes of this section and Section 9-108. However, the description contained in the security agreement, not the description in a public registry or on a certificate of title, controls for purposes of this section.

6. **Debtor's Rights; Debtor's Power to Transfer Rights.** Subsection (b)(2) conditions attachment on the debtor's having "rights in the collateral or the power to transfer rights in the collateral to a secured party." A debtor's limited rights in collateral, short of full ownership, are sufficient for a security interest to attach. However, in accordance with basic personal property conveyancing principles, the baseline rule is that a security interest attaches only to whatever rights a debtor may have, broad or limited as those rights may be.

Certain exceptions to the baseline rule enable a debtor to transfer, and a security interest to attach to, greater rights than the debtor has. See Part 3, Subpart 3 (priority rules). The phrase, "or the power to transfer rights in the collateral to a secured party," accommodates those exceptions. In some cases, a debtor may have power to transfer another person's rights only to a class of transferees that excludes secured parties. See, e.g., Section 2-403(2) (giving certain merchants power to transfer an entruster's rights to a buyer in ordinary course of business). Under those circumstances, the debtor would not have the power to create a security interest in the other person's rights, and the condition in subsection (b)(2) would not be satisfied.

7. **New Debtors.** Subsection (e) makes clear that the enforceability requirements of subsection (b)(3) are met when a new debtor becomes bound under an original debtor's security agreement. If a new debtor becomes bound as debtor by a security agreement entered into by another person, the security agreement satisfies the requirement of subsection (b)(3) as to the existing and after-acquired property of the new debtor to the extent the property is described in the agreement.

Subsection (d) explains when a new debtor becomes bound. Persons who become bound under paragraph (2) are limited to those who both become primarily liable for the original debtor's obligations and succeed to (or acquire) its assets. Thus, the paragraph excludes sureties and other secondary obligors as well as persons who become obligated through veil piercing and other non-successorship doctrines. In many cases, paragraph (2) will exclude successors to

the assets and liabilities of a division of a debtor. See also Section 9-508, Comment 3.

8. **Supporting Obligations.** Under subsection (f), a security interest in a "supporting obligation" (defined in Section 9-102) automatically follows from a security interest in the underlying, supported collateral. This result was implicit under former Article 9. Implicit in subsection (f) is the principle that the secured party's interest in a supporting obligation extends to the supporting obligation only to the extent that it supports the collateral in which the secured party has a security interest. Complex issues may arise, however, if a supporting obligation supports many separate obligations of a particular account debtor and if the supported obligations are separately assigned as security to several secured parties. The problems may be exacerbated if a supporting obligation is limited to an aggregate amount that is less than the aggregate amount of the obligations it supports. This Article does not contain provisions dealing with competing claims to a limited supporting obligation. As under former Article 9, the law of suretyship and the agreements of the parties will control.

9. **Collateral Follows Right to Payment or Performance.** Subsection (g) codifies the common-law rule that a transfer of an obligation secured by a security interest or other lien on personal or real property also transfers the security interest or lien. See Restatement (3d), Property (Mortgages) § 5.4(a) (1997). See also Section 9-308(e) (analogous rule for perfection).

10. **Investment Property.** Subsections (h) and (i) make clear that attachment of a security interest in a securities account or commodity account is also attachment in security entitlements or commodity contracts carried in the accounts.

ANNOTATION

Law reviews. For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Commercial and Corporate Law", which discusses a recent Tenth Circuit decision dealing with description of crops in financing statements, see 65 Den. U. L. Rev. 469 (1988).

Annotator's note. The following annotations include cases decided under this section as it existed prior to its 2001 repeal and reenactment.

When security interest may attach to debtor's accounts receivable. A security interest cannot attach to the accounts receivable of a debtor, if the debtor does not have a "right to payment", Weld Colo. Bank v. E & E Constr., Inc., 653 P.2d 758 (Colo. App. 1982).

Security interest may attach to accounts receivable of public contractor. A bank's security interest in the accounts receivable of a public contractor is valid only insofar as the contractor has rights to the funds retained by the public body to ensure the payment of any claims against the contractor. Where a supplier files a notice of claim with the public body, the contractor has no rights to these funds until this claim is settled. Thus, the security interest does not attach to these funds. Heinrichsdorff v. Raat, 655 P.2d 860 (Colo. App. 1982).

Right of reformation due to mutual mistake not displaced by this section in cases of security agreements. Although this section requires a security agreement to be in writing, the fact that an agreement must be in writing to satisfy a statute of frauds is not inconsistent with reformation of that written agreement if, by the reason of mutual mistake, the true agreement of the parties is not expressed in writing. Medallion Biomed., LLC v. Rosania, 298 B.R. 442 (Bankr. D. Colo. 2003).

Interest under § 38-22-127 claim takes priority over prior perfected security interest. An unsecured supplier claiming an interest under § 38-22-127, which imposes a trust fund for materialmen and laborers, takes priority over a prior perfected security interest in all present and future accounts receivable and proceeds of accounts. First Com. Corp. v. First Nat'l Bancorporation, Inc., 572 F. Supp. 1430 (D. Colo. 1983).

There is an inconsistency between this section and former § 4-9-306 on subject of proceeds. Fort Collins Prod. Credit Ass'n v. Carroll Dairy, 37 Colo. App. 536, 553 P.2d 95 (1976) (decided prior to the 1977 amendment of this section and § 4-9-306).

Lessor has no security interest in extracted gravel remaining on leased premises. The owner of a gravel pit who executes a lease allowing the extraction of gravel from his pit does not have a security interest in extracted gravel remaining on the leased premises after the right to extract gravel is terminated. The lessee acquires possession of the gravel once it is extracted. Palmer v. Corey (In re Musick Constr., Inc.), 34 Bankr. 105 (Bankr. D. Colo. 1983).

Security agreement which provides that secured collateral includes debtor's tangible personal property "now or hereafter acquired" does not cover property subsequently acquired by a third party who purchased debtor's property in foreclosure. This is true even though the third party has a director, officer, and

minority shareholder in common with the debtor. Vance v. Casebolt, 841 P.2d 394 (Colo. App. 1992).

Trial court did not err in holding that an unpaid seller in a cash sale did not take priority over a perfected security interest. UCC applies to determine when the title to heifers passed. Here title passed to debtor upon delivery of heifers to debtor. At the time of delivery creditor's interest in the heifers was sufficient to allow creditor's perfected security interest in after-acquired property to attach. This interest takes priority over the interests of the cash seller. Coop. Fin. Ass'n v. B & J Cattle, 937 P.2d 915 (Colo. App. 1997).

Trial court did not err that value had been given. Agreements, including assuming the responsibility to pay long-tem liabilities and entering into a security agreement, constituted sufficient consideration to support a simple contract. Compass Bank v. Kone, 134 P.3d 500 (Colo. App. 2006).

Under the circumstances, a stock redemption agreement and its various incorporated exhibits constitute an integrated and authenticated security agreement that provided a description of the collateral. Compass Bank v. Kone, 134 P.3d 500 (Colo. App. 2006).

Applied in Welbourne Dev. Co. v. Affiliated Clearance Corp., 28 Colo. App. 313, 472 P.2d 684 (1970); Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 32 Colo. App. 235, 511 P.2d 912 (1973), aff'd, 184 Colo. 166, 519 P.2d 354 (1974); Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977); Bank of Am. Nat'l Trust & Savings Ass'n v. Denver Hotel Ass'n Ltd. P'ship, 830 P.2d 1138 (Colo. App. 1992).

4-9-204. After-acquired property - future advances. (a) Except as otherwise provided in subsection (b) of this section, a security agreement may create or provide for a security interest in after-acquired collateral.

(b) A security interest does not attach under a term constituting an after-acquired property clause to:

(1) Consumer goods, other than an accession when given as additional security, unless the debtor acquires rights in them within ten days after the secured party gives value; or

(2) A commercial tort claim.

(c) A security agreement may provide that collateral secures, or that accounts, chattel paper, payment intangibles, or promissory notes are sold in connection with, future advances or other value, whether or not the advances or value are given pursuant to commitment.

Source: L. 2001: Entire article R&RE, p. 1336, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-204 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-204.

2. **After-Acquired Property; Continuing General Lien.** Subsection (a) makes clear that a security interest arising by virtue of an after-acquired property clause is no less valid than a security interest in collateral in which the debtor has rights at the time value is given. A security interest in after-acquired property is not merely an "equitable" interest; no further action by the secured party such as a supplemental agreement covering the new collateral is required. This section adopts the principle of a "continuing general lien" or "floating lien." It validates a security interest in the debtor's existing and (upon acquisition) future assets, even though the debtor has liberty to use or dispose of collateral without being required to account for proceeds or substitute new collateral. See Section 9-205. Subsection (a), together with subsection (c), also validates "cross-collateral" clauses under which collateral acquired at any time secures advances whenever made.

3. **After-Acquired Consumer Goods.** Subsection (b)(1) makes ineffective an after-acquired property clause covering consumer goods (defined in Section 9-109), except as accessions (see Section 9-335), acquired more than 10 days after the secured party gives value. Subsection (b)(1) is unchanged in substance from the corresponding provision in former Section 9-204(2).

4. **Commercial Tort Claims.** Subsection (b)(2) provides that an after-acquired property clause in a security agreement does not reach future commercial tort claims. In order for a security interest in a tort claim to attach, the claim must be in existence when the security agreement is authenticated. In addition, the security agreement must describe the tort claim with greater specificity than simply "all tort claims." See Section 9-108(e).

5. **Future Advances; Obligations Secured.** Under subsection (c) collateral may secure future as well as past or present advances if the

security agreement so provides. This is in line with the policy of this Article toward security interests in after-acquired property under subsection (a). Indeed, the parties are free to agree that a security interest secures any obligation whatsoever. Determining the obligations secured by collateral is solely a matter of construing the parties' agreement under applicable law. This Article rejects the holdings of cases decided under former Article 9 that applied other tests, such as whether a future advance or other subsequently incurred obligation was of the same or a similar type or class as earlier advances and obligations secured by the collateral.

6. **Sales of Receivables.** Subsections (a) and (c) expressly validate after-acquired property and future advance clauses not only when the transaction is for security purposes but also when the transaction is the sale of accounts, chattel paper, payment intangibles, or promissory notes.. This result was implicit under former Article 9.

7. **Financing Statements.** The effect of after-acquired property and future advance clauses as components of a security agreement should not be confused with the requirements applicable to financing statements under this Article's system of perfection by notice filing. The references to after-acquired property clauses and future advance clauses in this section are limited to security agreements. There is no need to refer to after-acquired property or future advances or other obligations secured in a financing statement. See Section 9-502, Comment 2.

ANNOTATION

Law reviews. For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Commercial and Corporate Law", which discusses a recent Tenth Circuit decision dealing with a participating bank's risk under a loan participation agreement, see 65 Den. U. L. Rev. 469 (1988).

Annotator's note. The following annotations include cases decided under this section as it existed prior to its 2001 repeal and reenactment.

It is determined when security interest may attach to debtor's accounts receivable. A security interest cannot attach to the accounts receivable of a debtor, if the debtor does not have a "right to payment". Weld Colo. Bank v. E & E Constr., Inc., 653 P.2d 758 (Colo. App. 1982).

Future advance clauses on printed forms are not to secure later purchases unless it is clear the parties contemplated this at the time the agreement was made. The true intent of the parties is the sole controlling factor. In re Grizaffi, 23 Bankr. 137 (Bankr. D. Colo. 1982).

"Floating liens" are limited. Even though "floating liens" are sanctioned under subsection (3), the secured party does not obtain a security interest in collateral for contingent contractual liabilities not of the same nature. In re Grizaffi, 23 Bankr. 137 (Bankr. D. Colo. 1982).

"Dragnet" clauses construed against drafter. A clause in a printed form attempting to draw in as security all other and future debts and all present and future property, which is called a "dragnet" clause, is to be construed strictly against the party drafting the clause. In re Grizaffi, 23 Bankr. 137 (Bankr. D. Colo. 1982).

Bank's security interest is attached at instant title certificates delivered. A bank's security interest in automobiles attached to the automobiles at the same instant that the titles were delivered to the bank. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

After the purchaser of some automobiles delivered its check to the seller, but before the certificates of title were transferred to a bank as the purchaser's agent, the purchaser executed a security agreement with the bank, intending to create a security interest in the automobiles to secure repayment of the bank's financing loan, until the certificates of title were properly transferred to the purchaser's agent, no right, title, or interest was created in the purchaser which would enable it to legally convey or encumber the automobiles. Therefore, although the bank and purchaser fully intended that the security interest attach to the automobiles at the time the loan funds were deposited in the purchaser's account, the absence of any legal right, title, or interest by the purchaser in the automobiles prevented the bank's security interest from attaching prior to the time that the certificates of title were delivered. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Attachment was never effected where bailee at the time it gave a security interest in its inventory to a bank had no rights of its own in the property. Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976).

Applied in Greeley Nat. Bank v. Sloan, 677 P.2d 409 (Colo. App. 1983); Janitell v. State Bank of Wiley, 919 P.2d 921 (Colo. App. 1996).

4-9-205. Use or disposition of collateral permissible. (a) A security interest is not invalid or fraudulent against creditors solely because:

(1) The debtor has the right or ability to:

(A) Use, commingle, or dispose of all or part of the collateral, including returned or repossessed goods;

(B) Collect, compromise, enforce, or otherwise deal with collateral;

(C) Accept the return of collateral or make repossessions; or

(D) Use, commingle, or dispose of proceeds; or

(2) The secured party fails to require the debtor to account for proceeds or replace collateral.

(b) This section does not relax the requirements of possession if attachment, perfection, or enforcement of a security interest depends upon possession of the collateral by the secured party.

Source: L. 2001: Entire article R&RE, p. 1336, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-205 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-205.

2. **Validity of Unrestricted "Floating Lien."** This Article expressly validates the "floating lien" on shifting collateral. See Sections 9-201, 9-204 and Comment 2. This section provides that a security interest is not invalid or fraudulent by reason of the debtor's liberty to dispose of the collateral without being required to account to the secured party for proceeds or substitute new collateral. As did former Section 9-205, this section repeals the rule of *Benedict v. Ratner*, 268 U.S. 353 (1925), and other cases which held such arrangements void as a matter of law because the debtor was given unfettered dominion or control over collateral. The *Benedict* rule did not effectively discourage or eliminate security transactions in inventory and receivables. Instead, it forced financing arrangements to be self-liquidating. Although this section repeals *Benedict*, the filing and other perfection requirements (see Part 3, Subpart 2, and Part 5) provide for public notice that overcomes any potential misleading effects of a debtor's use and control of collateral. Moreover, nothing in this section prevents the debtor and secured party from agreeing to procedures by which the secured party polices or monitors collateral or to restrictions on the debtor's dominion. However, this Article leaves these matters to agreement based on business considerations, not on legal requirements.

3. **Possessory Security Interests.** Subsection (b) makes clear that this section does not relax the requirements for perfection by possession under Section 9-313. If a secured party allows the debtor access to and control over collateral its security interest may be or become unperfected.

4. **Permissible Freedom for Debtor to Enforce Collateral.** Former Section 9-205 referred to a debtor's "liberty . . to collect or compromise accounts or chattel paper." This section recognizes the broader rights of a debtor to "enforce," as well as to "collect" and "compromise" collateral. This section's reference to collecting, compromising, and enforcing "collateral" instead of "accounts or chattel paper" contemplates the many other types of collateral that a debtor may wish to "collect, compromise, or enforce": e.g., deposit accounts, documents, general intangibles, instruments, investment property, and letter-of-credit rights.

4-9-206. Security interest arising in purchase or delivery of financial asset. (a) A security interest in favor of a securities intermediary attaches to a person's security entitlement if:

(1) The person buys a financial asset through the securities intermediary in a transaction in which the person is obligated to pay the purchase price to the securities intermediary at the time of the purchase; and

(2) The securities intermediary credits the financial asset to the buyer's securities account before the buyer pays the securities intermediary.

(b) The security interest described in subsection (a) of this section secures the person's obligation to pay for the financial asset.

(c) A security interest in favor of a person that delivers a certificated security or other financial asset represented by a writing attaches to the security or other financial asset if:

(1) The security or other financial asset:

(A) In the ordinary course of business is transferred by delivery with any necessary indorsement or assignment; and

(B) Is delivered under an agreement between persons in the business of dealing with such securities or financial assets; and

(2) The agreement calls for delivery against payment.

(d) The security interest described in subsection (c) of this section secures the obligation to make payment for the delivery.

Source: L. 2001: Entire article R&RE, p. 1337, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-116 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former 9-116.

2. **Codification of "Broker's Lien."** Depending upon a securities intermediary's arrangements with its entitlement holders, the securities intermediary may treat the entitlement holder as entitled to financial assets before the entitlement holder has actually made payment for them. For example, many brokers permit retail customers to pay for financial assets by check. The broker may not receive final payment of the check until several days after the broker has credited the customer's securities account for the financial assets. Thus, the customer will have acquired a security entitlement prior to payment. Subsection (a) provides that, in such circumstances, the securities intermediary has a security interest in the entitlement holder's security entitlement. Under subsection (b) the security interest secures the customer's obligation to pay for the financial asset in question. Subsections (a) and (b) codify and adapt to the indirect holding system the so-called "broker's lien," which has long been recognized. See Restatement, Security § 12.

3. **Financial Assets Delivered Against Payment.** Subsection (c) creates a security interest in favor of persons who deliver certificated securities or other financial assets in physical form, such as money market instruments, if the agreed payment is not received. In some arrangements for settlement of transactions in physical financial assets, the seller's securities custodian will deliver physical certificates to the buyer's securities custodian and receive a time-stamped delivery receipt. The buyer's securities custodian will examine the certificate to ensure that it is in good order, and that the delivery matches a trade in which the buyer has instructed the seller to deliver to that custodian. If all is in order, the receiving custodian will settle with the delivering custodian through whatever funds settlement system has been agreed upon or is used by custom and usage in that market. The understanding of the trade, however, is that the delivery is conditioned upon payment, so that if payment is not made for any reason, the security will be returned to the deliverer. Subsection (c) clarifies the rights of persons making deliveries in such circumstances. It provides the person making delivery with a security interest in the securities or other financial assets; under subsection (d), the security interest secures the seller's right to receive payment for the delivery. Section 8-301 specifies when delivery of a certificated security occurs; that section should be applied as well to other financial assets as well for purposes of this section.

4. **Automatic Attachment and Perfection.** Subsections (a) and (c) refer to attachment of a security interest. Attachment under this section has the same incidents (enforceability, right to proceeds, etc.) as attachment under Section 9-203. This section overrides the general attachment rules in Section 9-203. See Section 9-203(c). A securities intermediary's security interest under subsection (a) is perfected by control without further action. See Section 8-106 (control); 9-314 (perfection). Security interests arising under subsection (c) are automatically perfected. See Section 9-309(9).

4-9-207. Rights and duties of secured party having possession or control of collateral. (a) Except as otherwise provided in subsection (d) of this section, a secured party shall use reasonable care in the custody and preservation of collateral in the secured party's possession. In the case of chattel paper or an instrument, reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(b) Except as otherwise provided in subsection (d) of this section, if a secured party has possession of collateral:

(1) Reasonable expenses, including the cost of insurance and payment of taxes or other charges, incurred in the custody, preservation, use, or operation of the collateral are chargeable to the debtor and are secured by the collateral;

(2) The risk of accidental loss or damage is on the debtor to the extent of a deficiency in any effective insurance coverage;

(3) The secured party shall keep the collateral identifiable, but fungible collateral may be commingled; and

(4) The secured party may use or operate the collateral:

(A) For the purpose of preserving the collateral or its value;

(B) As permitted by an order of a court having competent jurisdiction; or

(C) Except in the case of consumer goods, in the manner and to the extent agreed by the debtor.

(c) Except as otherwise provided in subsection (d) of this section, a secured party having possession of collateral or control of collateral under section 4-7-106, 4-9-104, 4-9-105, 4-9-106, or 4-9-107:

(1) May hold as additional security any proceeds, except money or funds, received from the collateral;

(2) Shall apply money or funds received from the collateral to reduce the secured obligation, unless remitted to the debtor; and

(3) May create a security interest in the collateral.

(d) If the secured party is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor:

(1) Subsection (a) of this section does not apply unless the secured party is entitled under an agreement:

(A) To charge back uncollected collateral; or

(B) Otherwise to full or limited recourse against the debtor or a secondary obligor based on the nonpayment or other default of an account debtor or other obligor on the collateral; and

(2) Subsections (b) and (c) of this section do not apply.

Source: L. 2001: Entire article R&RE, p. 1337, § 1, effective July 1. **L. 2006:** IP(c) amended, p. 500, § 35, effective September 1.

Editor's note: This section is similar to former § 4-9-207 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-207.

2. **Duty of Care for Collateral in Secured Party's Possession.** Like former section 9-207, subsection (a) imposes a duty of care, similar to that imposed on a pledgee at common law, on a secured party in possession of collateral. See Restatement, Security §§ 17, 18. In many cases a secured party in possession of collateral may satisfy this duty by notifying the debtor of action that should be taken and allowing the debtor to take the action itself. If the secured party itself takes action, its reasonable expenses may be added to the secured obligation. The revised definitions of "collateral," "debtor," and "secured party" in Section 9-102 make this section applicable to collateral subject to an agricultural lien if the collateral is in the lienholder's possession. Under Section 1-102 the duty to exercise reasonable care may not be disclaimed by agreement, although under that section the parties remain free to determine by agreement standards that are not manifestly unreasonable as to what constitutes reasonable care. Unless otherwise agreed, for a secured party in possession of chattel paper or an instrument, reasonable care includes the preservation of rights against prior parties. The secured party's right to have instruments or documents indorsed or transferred to it or its order is dealt with in the relevant sections of Articles 3, 7, and 8. See Sections 3-201, 7-506, 8-304(d).

Note: "Section 1-102" in the fifth sentence and "Section 3-201," in the last sentence will be replaced with "Section 1-302" and "Section 3-203(c)," respectively, effective July 1, 2013.

3. **Specific Rules When Secured Party in Possession or Control of Collateral.** Subsections (b) and (c) provide rules following common-law precedents which apply unless the parties otherwise agree. The rules in subsection (b) apply to typical issues that may arise while a secured party is in possession of collateral, including expenses, insurance, and taxes, risk of loss or damage, identifiable and fungible collateral, and use or operation of collateral. Subsection (c) contains rules that apply in certain circumstances that may arise when a secured party is in either possession or control of collateral. These circumstances include the secured party's receiving proceeds from the collateral and the secured party's creation of a security interest in the collateral.

4. **Applicability Following Default.** This section applies when the secured party has pos-

session of collateral either before or after default. See Sections 9-601(b), 9-609. Subsection (b)(4)(C) limits agreements concerning the use or operation of collateral to collateral other than consumer goods. Under Section 9-602(1), a debtor cannot waive or vary that limitation.

5. **"Repledges" and Right of Redemption.** Subsection (c)(3) eliminates the qualification in former Section 9-207 to the effect that the terms of a "repledge" may not "impair" a debtor's "right to redeem" collateral. The change is primarily for clarification. There is no basis on which to draw from subsection (c)(3) any inference concerning the debtor's right to redeem the collateral. The debtor enjoys that right under Section 9-623; this section need not address it. For example, if the collateral is a negotiable note that the secured party (SP-1) repledges to SP-2, nothing in this section suggests that the debtor (D) does not retain the right to redeem the note upon payment to SP-1 of all obligations secured by the note. But, as explained below, the debtor's unimpaired right to redeem as against the debtor's original secured party nevertheless may not be enforceable as against the new secured party.

In resolving questions that arise from the creation of a security interest by SP-1, one must take care to distinguish D's rights against SP-1 from D's rights against SP-2. Once D discharges the secured obligation, D becomes entitled to the note; SP-1 has no legal basis upon which to withhold it. If, as a practical matter, SP-1 is unable to return the note because SP-2 holds it as collateral for SP-1's unpaid debt, then SP-1 is liable to D under the law of conversion.

Whether SP-2 would be liable to D depends on the relative priority of SP-2's security interest and D's interest. By permitting SP-1 to create a security interest in the collateral (repledge), subsection (c)(3) provides a statutory power for SP-1 to give SP-2 a security interest (subject, of course, to any agreement by SP-1 not to give a security interest). In the vast majority of cases where repledge rights are significant, the security interest of the second secured party, SP-2 in the example, will be senior to the debtor's interest. By virtue of the debtor's consent or applicable legal rules, SP-2 typically would cut off D's rights in investment property or be immune from D's claims. See Sections 9-331, 3-306 (holder in due course), 8-303 (protected purchaser), 8-502 (acquisition of a security entitlement), 8-503(e) (action by entitlement holder). Moreover, the expectations and business practices in some markets, such as the securities markets, are such that D's consent to SP-2's taking free of D's rights inheres in D's creation of SP-1's security interest which gives rise to SP-1's power under this section. In these situations, D would have no right to recover the collateral or recover damages from SP-2. Nevertheless, D would have a damage claim against SP-1 if SP-1 had given a security interest to SP-2 in breach of its agreement with D. Moreover, if SP-2's security interest secures an amount that is less than the amount secured by SP-1's security interest (granted by D), then D's exercise of its right to redeem would provide value sufficient to discharge SP-1's obligations to SP-2.

For the most part this section does not change the law under former Section 9-207, although eliminating the reference to the debtor's right of redemption may alter the secured party's right to repledge in one respect. Former Section 9-207 could have been read to limit the secured party's statutory right to repledge collateral to repledge transactions in which the collateral did not secure a greater obligation than that of the original debtor. Inasmuch as this is a matter normally dealt with by agreement between the debtor and secured party, any change would appear to have little practical effect.

6. **"Repledges" of Investment Property.** The following example will aid the discussion of "repledges" of investment property.

Example. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha does not have an account with Able. Alpha uses Beta Bank as its securities custodian. Debtor instructs Able to transfer the shares to Beta, for the account of Alpha, and Able does so. Beta then credits Alpha's account. Alpha has control of the security entitlement for the 1000 shares under Section 8-106(d). (These are the facts of Example 2, Section 8-106, Comment 4.) Although, as between Debtor and Alpha, Debtor may have become the beneficial owner of the new securities entitlement with Beta, Beta has agreed to act on Alpha's entitlement orders because, as between Beta and Alpha, Alpha has become the entitlement holder.

Next, Alpha grants Gamma Bank a security interest in the security entitlement with Beta that includes the 1000 shares of XYZ Co. stock. In order to afford Gamma control of the entitlement, Alpha instructs Beta to transfer the stock to Gamma's custodian, Delta Bank, which credits Gamma's account for 1000 shares. At this point Gamma holds its securities entitlement for its benefit as well as that of its debtor, Alpha. Alpha's derivative rights also are for the benefit of Debtor.

In many, probably most, situations and at any particular point in time, it will be impossible for Debtor or Alpha to "trace" Alpha's "repledge" to any particular securities entitlement or financial asset of Gamma or anyone else. Debtor would retain, of course, a right to redeem the collateral from Alpha upon satisfaction of the secured obligation. However, in the absence of a traceable interest, Debtor would retain only a personal claim against Alpha in the event Alpha

failed to restore the security entitlement to Debtor. Moreover, even in the unlikely event that Debtor could trace a property interest, in the context of the financial markets, normally the operation of this section, Debtor's explicit agreement to permit Alpha to create a senior security interest, or legal rules permitting Gamma to cut off Debtor's rights or become immune from Debtor's claims would effectively subordinate Debtor's interest to the holder of a security interest created by Alpha. And, under the shelter principle, all subsequent transferees would obtain interests to which Debtor's interest also would be subordinate.

7. **Buyers of Chattel Paper and Other Receivables; Consignors.** This section has been revised to reflect the fact that a seller of accounts, chattel paper, payment intangibles, or promissory notes retains no interest in the collateral and so is not disadvantaged by the secured party's noncompliance with the requirements of this section. Accordingly, subsection (d) provides that subsection (a) applies only to security interests that secure an obligation and to sales of receivables in which the buyer has recourse against the debtor. (Of course, a buyer of accounts or payment intangibles could not have "possession" of original collateral, but might have possession of proceeds, such as promissory notes or checks.) The meaning of "recourse" in this respect is limited to recourse arising out of the account debtor's failure to pay or other default.

Subsection (d) makes subsections (b) and (c) inapplicable to buyers of accounts, chattel paper, payment intangibles, or promissory notes and consignors. Of course, there is no reason to believe that a buyer of receivables or a consignor could not, for example, create a security interest or otherwise transfer an interest in the collateral, regardless of who has possession of the collateral. However, this section leaves the rights of those owners to law other than Article 9.

ANNOTATION

Law reviews. For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983).

Annotator's note. The following annotations include a case decided under this section as it existed prior to its 2001 repeal and reenactment.

Buyer vested with security interest upon revocation of acceptance. If a revocation of acceptance of a mobile home is justifiable under § 4-2-608, § 4-2-711(3) vests the buyer with a security interest in the home, and such an interest authorizes continued possession to preserve the collateral, pursuant to this section, subject to the seller's right to an offset for the rental value of the home. Keen v. Modern Trailer Sales, Inc., 40 Colo. App. 527, 578 P.2d 668 (1978).

4-9-208. Additional duties of secured party having control of collateral. (a) This section applies to cases in which there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations, or otherwise give value.

(b) Within five business days after receiving an authenticated demand by the debtor:

(1) A secured party having control of a deposit account under section 4-9-104 (a) (2) shall send to the bank with which the deposit account is maintained an authenticated statement that releases the bank from any further obligation to comply with instructions originated by the secured party;

(2) A secured party having control of a deposit account under section 4-9-104 (a) (3) shall:

(A) Pay the debtor the balance on deposit in the deposit account; or

(B) At the request of the debtor, transfer the balance on deposit into a deposit account in the debtor's name, providing sufficient information so that the debtor can access the deposit account.

(2.5) The amount due the debtor shall also include all interest earned on the deposit account to the extent not already credited to the deposit account or paid to the debtor from the date the conditions in subsection (a) of this section are satisfied.

(3) A secured party, other than a buyer, having control of electronic chattel paper under section 4-9-105 shall:

(A) Communicate the authoritative copy of the electronic chattel paper to the debtor or its designated custodian;

(B) If the debtor designates a custodian that is the designated custodian with which the authoritative copy of the electronic chattel paper is maintained for the secured party,

communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and

(C) Take appropriate action to enable the debtor or its designated custodian to make copies of or revisions to the authoritative copy which add or change an identified assignee of the authoritative copy without the consent of the secured party;

(4) A secured party having control of investment property under section 4-8-106 (d) (2) or 4-9-106 (b) shall send to the securities intermediary or commodity intermediary with which the security entitlement or commodity contract is maintained an authenticated record that releases the securities intermediary or commodity intermediary from any further obligation to comply with entitlement orders or directions originated by the secured party;

(5) A secured party having control of a letter-of-credit right under section 4-9-107 shall send to each person having an unfulfilled obligation to pay or deliver proceeds of the letter of credit to the secured party an authenticated release from any further obligation to pay or deliver proceeds of the letter of credit to the secured party; and

(6) A secured party having control of an electronic document shall:

(A) Give control of the electronic document to the debtor or its designated custodian;

(B) If the debtor designates a custodian that is the designated custodian with which the authoritative copy of the electronic document is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and

(C) Take appropriate action to enable the debtor or its designated custodian to make copies of or revisions to the authoritative copy that add or change an identified assignee of the authoritative copy without the consent of the secured party.

Source: L. 2001: Entire article R&RE, p. 1338, § 1, effective July 1. **L. 2006:** (b)(4) and (b)(5) amended and (b)(6) added, p. 500, § 36, effective September 1.

Editor's note - Colorado legislative change: Colorado substituted the phrase "five business" for the word "10" in the introductory portion to subsection (b), added the phrases "At the request of the debtor," and "providing sufficient information so that the debtor can access the deposit account" in subsection (b)(2)(B), and added a new subsection (b)(2.5).

OFFICIAL COMMENT

1. **Source.** New.

2. **Scope and Purpose.** This section imposes duties on a secured party who has control of a deposit account, electronic chattel paper, investment property, or a letter-of-credit right. The duty to terminate the secured party's control is analogous to the duty to file a termination statement, imposed by Section 9-513. Under subsection (a), it applies only when there is no outstanding secured obligation and the secured party is not committed to give value. The requirements of this section can be varied by agreement under Section 1-102(3). For example, a debtor could by contract agree that the secured party may comply with subsection (b) by releasing control more than 10 days after demand. Also, duties under this section should not be read to conflict with the terms of the collateral itself. For example, if the collateral is a time deposit account, subsection (b)(2) should not require a secured party with control to make an early withdrawal of the funds (assuming that were possible) in order to pay them over to the debtor or put them in an account in the debtor's name.

3. **Remedy for Failure to Relinquish Control.** If a secured party fails to comply with the requirements of subsection (b), the debtor has the remedy set forth in Section 9-625(e). This remedy is identical to that applicable to failure to provide or file a termination statement under Section 9-513.

4. **Duty to Relinquish Possession.** Although Section 9-207 addresses directly the duties of a secured party in possession of collateral, that section does not require the secured party to relinquish possession when the secured party ceases to hold a security interest. Under common law, absent agreement to the contrary, the failure to relinquish possession of collateral upon satisfaction of the secured obligation would constitute a conversion. Inasmuch as problems apparently have not surfaced in the absence of statutory duties under former Article 9 and the common-law duty appears to have been sufficient, this Article does not impose a statutory duty to relinquish possession.

4-9-209. Duties of secured party if account debtor has been notified of assignment. (a) Except as otherwise provided in subsection (c) of this section, this section applies if:

(1) There is no outstanding secured obligation; and

(2) The secured party is not committed to make advances, incur obligations, or otherwise give value.

(b) Within ten days after receiving an authenticated demand by the debtor, a secured party shall send to an account debtor that has received notification of an assignment to the secured party as assignee under section 4-9-406 (a) an authenticated record that releases the account debtor from any further obligation to the secured party.

(c) This section does not apply to an assignment constituting the sale of an account, chattel paper, or payment intangible.

Source: L. 2001: Entire article R&RE, p. 1340, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Scope and Purpose.** Like Sections 9-208 and 9-513, which require a secured party to relinquish control of collateral and to file or provide a termination statement for a financing statement, this section requires a secured party to free up collateral when there no longer is any outstanding secured obligation or any commitment to give value in the future. This section addresses the case in which account debtors have been notified to pay a secured party to whom the receivables have been assigned. It requires the secured party (assignee) to inform the account debtors that they no longer are obligated to make payment to the secured party. See subsection (b). It does not apply to account debtors whose obligations on an account, chattel paper, or payment intangible have been sold. See subsection (c).

4-9-210. Request for accounting - request regarding list of collateral or statement of account - definitions. (a) In this section:

(1) "Request" means a record of a type described in paragraph (2), (3), or (4) of this subsection (a).

(2) "Request for an accounting" means a record authenticated by a debtor requesting that the recipient provide an accounting of the unpaid obligations secured by collateral and reasonably identifying the transaction or relationship that is the subject of the request.

(3) "Request regarding a list of collateral" means a record authenticated by a debtor requesting that the recipient approve or correct a list of what the debtor believes to be the collateral securing an obligation and reasonably identifying the transaction or relationship that is the subject of the request.

(4) "Request regarding a statement of account" means a record authenticated by a debtor requesting that the recipient approve or correct a statement indicating what the debtor believes to be the aggregate amount of unpaid obligations secured by collateral as of a specified date and reasonably identifying the transaction or relationship that is the subject of the request.

(b) Subject to subsections (c), (d), (e), and (f) of this section, a secured party, other than a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor, shall comply with a request within fourteen days after receipt:

(1) In the case of a request for an accounting, by authenticating and sending to the debtor an accounting; and

(2) In the case of a request regarding a list of collateral or a request regarding a statement of account, by authenticating and sending to the debtor an approval or correction.

(c) A secured party that claims a security interest in all of a particular type of collateral owned by the debtor may comply with a request regarding a list of collateral by sending to the debtor an authenticated record including a statement to that effect within fourteen days after receipt.

(d) A person that receives a request regarding a list of collateral, claims no interest in the collateral when it receives the request, and that claimed an interest in the collateral at an earlier time shall comply with the request within fourteen days after receipt by sending to the debtor an authenticated record:

(1) Disclaiming any interest in the collateral; and

(2) If known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's interest in the collateral.

(e) A person that receives a request for an accounting or a request regarding a statement of account, claims no interest in the obligations when it receives the request, and that claimed an interest in the obligations at an earlier time shall comply with the request within fourteen days after receipt by sending to the debtor an authenticated record:

(1) Disclaiming any interest in the obligations; and

(2) If known to the recipient, providing the name and mailing address of any assignee of or successor to the recipient's interest in the obligations.

(f) A debtor is entitled without charge to a response to a request under this section during any six-month period for each (i) an accounting, (ii) regarding a list of collateral, and (iii) regarding a statement of account. The secured party may require payment of a charge, not exceeding fifteen dollars, for each additional response. Wherever the term "debtor" is used in this section, it means either the debtor or the person designated by the debtor to receive a response in a notification authenticated by the debtor and received by the secured party or other applicable person at or prior to the time of a request.

Source: L. 2001: Entire article R&RE, p. 1340, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-208 as it existed prior to 2001.

(2) **Colorado legislative change:** In subsection (f), Colorado changed the word "one" to "a", added the phrase "for each (i) an accounting, (ii) regarding a list of collateral, and (iii) regarding a statement of account", changed the fee from $25 to $15, and added the last sentence.

OFFICIAL COMMENT

1. **Source.** Former Section 9-208.

2. **Scope and Purpose.** This section provides a procedure whereby a debtor may obtain from a secured party information about the secured obligation and the collateral in which the secured party may claim a security interest. It clarifies and resolves some of the issues that arose under former Section 9-208 and makes information concerning the secured indebtedness readily available to debtors, both before and after default. It applies to agricultural lien transactions (see the definitions of "debtor," secured party," and "collateral" in Section 9-102), but generally not to sales of receivables. See subsection (b).

3. **Requests by Debtors Only.** A financing statement filed under Part 5 may disclose only that a secured party may have a security interest in specified types of collateral. In most cases the financing statement will contain no indication of the obligation (if any) secured, whether any security interest actually exists, or the particular property subject to a security interest. Because creditors of and prospective purchasers from a debtor may have legitimate needs for more detailed information, it is necessary to provide a procedure under which the secured party will be required to provide information. On the other hand, the secured party should not be under a duty to disclose any details of the debtor's financial affairs to any casual inquirer or competitor who may inquire. For this reason, this section gives the right to request information to the debtor only. The debtor may submit a request in connection with negotiations with subsequent creditors and purchasers, as well as for the purpose of determining the status of its credit relationship or demonstrating which of its assets are free of a security interest.

4. **Permitted Types of Requests for Information.** Subsection (a) contemplates that a debtor may request three types of information by submitting three types of "requests" to the secured party. First, the debtor may request the secured party to prepare and send an "accounting" (defined in Section 9-102). Second, the debtor may submit to the secured party a list of collateral for the secured party's approval or correction. Third, the debtor may submit to the secured party for its approval or correction a statement of the aggregate amount of unpaid secured obligations. Inasmuch as a secured party may have numerous transactions and relationships with a debtor, each request must identify the relevant transactions or relationships. Subsections (b) and (c) require the secured party to respond to a request within 14 days following receipt of the request.

5. **Recipients Claiming No Interest in the Transaction.** A debtor may be unaware that a creditor with whom it has dealt has assigned its security interest or the secured obligation. Subsections (d) and (e) impose upon recipients of requests under this section the duty to inform the debtor that they claim no interest in the collateral or secured obligation, respectively, and to

inform the debtor of the name and mailing address of any known assignee or successor. As under subsections (b) and (c), a response to a request under subsection (d) or (e) is due 14 days following receipt.

6. **Waiver; Remedy for Failure to Comply.** The debtor's rights under this section may not be waived or varied. See Section 9-602(2). Section 9-625 sets forth the remedies for noncompliance with the requirements of this section.

7. **Limitation on Free Responses to Requests.** Under subsection (f), during a six-month period a debtor is entitled to receive from the secured party one free response to a request. The debtor is not entitled to a free response to *each* type of request (i.e., three free responses) during a six-month period.

ANNOTATION

Annotator's note. Since § 4-9-210 is similar to § 4-9-208 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

If a potential creditor seeks more detailed information, he may request it from the debtor, and the burden shifts to the debtor to contact the secured party for specific details. In re Colorado Mercantile Co., 299 F. Supp. 55 (D. Colo. 1969).

Applied in Platte Valley Bank v. B & J Constr., Inc., 44 Colo. App. 21, 606 P.2d 455 (1980).

PART 3

PERFECTION AND PRIORITY

4-9-301. Law governing perfection and priority of security interests. Except as otherwise provided in sections 4-9-303 to 4-9-306, the following rules determine the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral:

(1) Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.

(2) While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest in that collateral.

(3) Except as otherwise provided in paragraph (4) of this section, while tangible negotiable documents, goods, instruments, money, or tangible chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:

(A) Perfection of a security interest in the goods by filing a fixture filing;

(B) Perfection of a security interest in timber to be cut; and

(C) The effect of perfection or nonperfection and the priority of a nonpossessory security interest in the collateral.

(4) The local law of the jurisdiction in which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral.

Source: L. 2001: Entire article R&RE, p. 1341, § 1, effective July 1. **L. 2006:** IP(3) amended, p. 501, § 37, effective September 1.

Editor's note: This section is similar to former § 4-9-103 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Sections 9-103(1)(a), (b), 9-103(3)(a), (b), 9-103(5), substantially modified.

2. **Scope of This Subpart.** Part 3, Subpart 1 (Sections 9-301 through 9-307) contains choice-of-law rules similar to those of former Section 9-103. Former Section 9-103 generally addresses which State's law governs "perfection and the effect of perfection or non- perfection of" security interests. See, e.g., former Section

9-103(1)(b). This Article follows the broader and more precise formulation in former Section 9-103(6)(b), which was revised in connection with the promulgation of Revised Article 8 in 1994: "perfection, the effect of perfection or non-perfection, and the priority of" security interests. Priority, in this context, subsumes all of the rules in Part 3, including "cut off" or "take free" rules such as Sections 9-317(b), (c), and (d), 9-320(a), (b), and (d), and 9-332. This subpart does not address choice of law for other purposes. For example, the law applicable to issues such as attachment, validity, characterization (e.g., true lease or security interest), and enforcement is governed by the rules in Section 1-105; that governing law typically is specified in the same agreement that contains the security agreement. And, another jurisdiction's law may govern other third-party matters addressed in this Article. See Section 9-401, Comment 3.
Note: "Section 1-105;" in the second to last sentence will be replaced with "Section 1-301;" effective July 1, 2013.

3. **Scope of Referral.** In designating the jurisdiction whose law governs, this Article directs the court to apply only the substantive ("local") law of a particular jurisdiction and not its choice-of-law rules.

Example 1: Litigation over the priority of a security interest in accounts arises in State X. State X has adopted the official text of this Article, which provides that priority is determined by the local law of the jurisdiction in which the debtor is located. See Section 9-301(1). The debtor is located in State Y. Even if State Y has retained former Article 9 or enacted a nonuniform choice-of-law rule (e.g., one that provides that perfection is governed by the law of State Z), a State X court should look only to the substantive law of State Y and disregard State Y's choice-of-law rule. State Y's substantive law (e.g., its Section 9-501) provides that financing statements should be filed in a filing office in State Y. Note, however, that if the identical perfection issue were to be litigated in State Y, the court would look to State Y's former Section 9-103 or nonuniform 9-301 and conclude that a filing in State Y is ineffective.

Example 2: In the preceding Example, assume that State X has adopted the official text of this Article, and State Y has adopted a nonuniform Section 9-301(1) under which perfection is governed by the whole law of State X, including its choice-of-law rules. If litigation occurs in State X, the court should look to the substantive law of State Y, which provides that financing statements are to be filed in a filing office in State Y. If litigation occurs in State Y, the court should look to the law of State X, whose choice-of-law rule requires that the court apply the substantive law of State Y. Thus, regardless of the jurisdiction in which the litigation arises, the financing statement should be filed in State Y.

4. **Law Governing Perfection: General Rule.** Paragraph (1) contains the general rule: the law governing perfection of security interests in both tangible and intangible collateral, whether perfected by filing or automatically, is the law of the jurisdiction of the debtor's location, as determined under Section 9-307.

Paragraph (1) substantially simplifies the choice-of-law rules. Former Section 9-103 contained different choice-of-law rules for different types of collateral. Under Section 9-301(1), the law of a single jurisdiction governs perfection with respect to most types of collateral, both tangible and intangible. Paragraph (1) eliminates the need for former Section 9-103(1)(c), which concerned purchase-money security interests in tangible collateral that is intended to move from one jurisdiction to the other. It is likely to reduce the frequency of cases in which the governing law changes after a financing statement is properly filed. (Presumably, debtors change their own location less frequently than they change the location of their collateral.) The approach taken in paragraph (1) also eliminates some difficult priority issues and the need to distinguish between "mobile" and "ordinary" goods, and it reduces the number of filing offices in which secured parties must file or search when collateral is located in several jurisdictions.

5. **Law Governing Perfection: Exceptions.** The general rule is subject to several exceptions. It does not apply to goods covered by a certificate of title (see Section 9-303), deposit accounts (see Section 9-304), investment property (see Section 9-305), or letter-of-credit rights (see Section 9-306). Nor does it apply to possessory security interests, i.e., security interests that the secured party has perfected by taking possession of the collateral (see paragraph (2)), security interests perfected by filing a fixture filing (see subparagraph (3)(A)), security interests in timber to be cut (subparagraph (3)(B)), or security interests in as-extracted collateral (see paragraph (4)).

a. **Possessory Security Interests.** Paragraph (2) applies to possessory security interests and provides that perfection is governed by the local law of the jurisdiction in which the collateral is located. This is the rule of former Section 9-103(1)(b), except paragraph (2) eliminates the troublesome "last event" test of former law.

The distinction between nonpossessory and possessory security interests creates the potential for the same jurisdiction to apply two different choice-of-law rules to determine perfection in the same collateral. For example, were a secured party in possession of an instrument or document to relinquish possession in reliance on temporary perfection, the applicable law immediately would change from that of the location of the collateral to that of the location of the debtor. The applicability of two different choice-

of-law rules for perfection is unlikely to lead to any material practical problems. The perfection rules of one Article 9 jurisdiction are likely to be identical to those of another. Moreover, under paragraph (3), the relative priority of competing security interests in tangible collateral is resolved by reference to the law of the jurisdiction in which the collateral is located, regardless of how the security interests are perfected.

b. **Fixtures.** Application of the general rule in paragraph (1) to perfection of a security interest in fixtures would yield strange results. For example, perfection of a security interest in fixtures located in Arizona and owned by a Delaware corporation would be governed by the law of Delaware. Although Delaware law would send one to a filing office in Arizona for the place to file a financing statement as a fixture filing, see Section 9-501, Delaware law would not take account of local, nonuniform, real-property filing and recording requirements that Arizona law might impose. For this reason, paragraph (3)(A) contains a special rule for security interests perfected by a fixture filing; the law of the jurisdiction in which the fixtures are located governs perfection, including the formal requisites of a fixture filing. Under paragraph (3)(C), the same law governs priority. Fixtures are "goods" as defined in Section 9-102.

Note: This version of comment b. is effective until July 1, 2013.

b. **Fixture Filings.** Under the general rule in paragraph (1), a security interest in fixtures may be perfected by filing in the office specified by Section 9-501(a) as enacted in the jurisdiction in which the debtor is located. However, application of this rule to perfection of a security interest by filing a fixture filing could yield strange results. For example, perfection of a security interest in fixtures located in Arizona and owned by a Delaware corporation would be governed by the law of Delaware. Although Delaware law would send one to a filing office in Arizona for the place to file a financing statement as a fixture filing, see Section 9-501, Delaware law would not take account of local, nonuniform, real-property filing and recording requirements that Arizona law might impose. For this reason, paragraph (3)(A) contains a special rule for security interests perfected by a fixture filing; the law of the jurisdiction in which the fixtures are located governs perfection, including the formal requisites of a fixture filing. Under paragraph (3)(C), the same law governs priority. Fixtures are "goods" as defined in Section 9-102.

Note: This version of comment b. takes effect July 1, 2013.

[The filing of a financing statement to perfect a security interest in collateral of a transmitting utility constitutes a fixture filing with respect to goods that are or become fixtures. See Section 9-501(b). Accordingly, to perfect a security interest in goods of this kind by a fixture filing, a financing statement must be filed in the office specified by Section 9-501(b) as enacted in the jurisdiction in which the goods are located. If the fixtures collateral is located in more than one State, filing in all of those States will be necessary to perfect a security interest in all the fixtures collateral by a fixture filing. Of course, a security interest in nearly all types of collateral (including fixtures) of a transmitting utility may be perfected by filing in the office specified by Section 9-501(b) as enacted in the jurisdiction in which the transmitting utility is located. However, such a filing will not be effective as a fixture filing except with respect to goods that are located in that jurisdiction.]

Note: The bracketed language takes effect July 1, 2013.

c. **Timber to Be Cut.** Application of the general rule in paragraph (1) to perfection of a security interest in timber to be cut would yield undesirable results analogous to those described with respect to fixtures. Paragraph (3)(B) adopts a similar solution: perfection is governed by the law of the jurisdiction in which the timber is located. As with fixtures, under paragraph (3)(C), the same law governs priority. Timber to be cut also is "goods" as defined in Section 9-102.

Paragraph (3)(B) applies only to "timber to be cut," not to timber that has been cut. Consequently, once the timber is cut, the general choice-of-law rule in paragraph (1) becomes applicable. To ensure continued perfection, a secured party should file in both the jurisdiction in which the timber to be cut is located and in the state where the debtor is located. The former filing would be with the office in which a real property mortgage would be filed, and the latter would be a central filing. See Section 9-501.

d. **As-Extracted Collateral.** Paragraph (4) adopts the rule of former Section 9-103(5) with respect to certain security interests in minerals and related accounts. Like security interests in fixtures perfected by filing a fixture filing, security interests in minerals that are as-extracted collateral are perfected by filing in the office designated for the filing or recording of a mortgage on the real property. For the same reasons, the law governing perfection and priority is the law of the jurisdiction in which the wellhead or minehead is located.

6. **Change in Law Governing Perfection.** When the debtor changes its location to another jurisdiction, the jurisdiction whose law governs perfection under paragraph (1) changes, as well. Similarly, the law governing perfection of a possessory security interest in collateral under paragraph (2) changes when the collateral is removed to another jurisdiction. Nevertheless, these changes will not result in an immediate loss of perfection. See Section 9-316(a), (b).

7. **Law Governing Effect of Perfection and Priority: Goods, Documents, Instruments,**

Money, Negotiable Documents, and Tangible Chattel Paper. Under former Section 9-103, the law of a single jurisdiction governed both questions of perfection and those of priority. This Article generally adopts that approach. See paragraph (1). But the approach may create problems if the debtor and collateral are located in different jurisdictions. For example, assume a security interest in equipment located in Pennsylvania is perfected by filing in Illinois, where the debtor is located. If the law of the jurisdiction in which the debtor is located were to govern priority, then the priority of an execution lien on goods located in Pennsylvania would be governed by rules enacted by the Illinois legislature.

To address this problem, paragraph (3)(C) divorces questions of perfection from questions of "the effect of perfection or nonperfection and the priority of a security interest." Under paragraph (3)(C), the rights of competing claimants to tangible collateral are resolved by reference to the law of the jurisdiction in which the collateral is located. A similar bifurcation applied to security interests in investment property under former Section 9-103(6). See Section 9-305.

Paragraph (3)(C) applies the law of the situs to determine priority only with respect to goods (including fixtures), instruments, money, negotiable documents, and tangible chattel paper. Compare former Section 9-103(1), which applied the law of the location of the collateral to documents, instruments, and "ordinary" (as opposed to "mobile") goods. This Article does not distinguish among types of goods. The ordinary/mobile goods distinction appears to address concerns about where to file and search, rather than concerns about priority. There is no reason to preserve this distinction under the bifurcated approach.

Particularly serious confusion may arise when the choice-of-law rules of a given jurisdiction result in each of two competing security interests in the same collateral being governed by a different priority rule. The potential for this confusion existed under former Section 9-103(4) with respect to chattel paper: Perfection by possession was governed by the law of the location of the paper, whereas perfection by filing was governed by the law of the location of the debtor. Consider the mess that would have been created if the language or interpretation of former Section 9-308 were to differ in the two relevant States, or if one of the relevant jurisdictions (e.g., a foreign country) had not adopted Article 9. The potential for confusion could have been exacerbated when a secured party perfected both by taking possession in the State where the collateral is located (State A) and by filing in the State where the debtor is located (State B) a common practice for some chattel paper financers. By providing that the law of the jurisdiction in which the collateral is located governs priority, paragraph (3) substantially diminishes this problem.

8. **Non-U.S. Debtors.** This Article applies the same choice-of-law rules to all debtors, foreign and domestic. For example, it adopts the bifurcated approach for determining the law applicable to security interests in goods and other tangible collateral. See Comment 5.a., above. The Article contains a new rule specifying the location of non-U.S. debtors for purposes of this Part. The rule appears in Section 9-307 and is explained in the Comments to that section. Former Section 9-103(3)(c), which contained a special choice-of-law rule governing security interests created by debtors located in a non-U.S. jurisdiction, proved unsatisfactory and was deleted.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Annotator's note. Since § 4-9-301 is similar to § 4-9-103 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

The validity of foreign security interests in personal property is governed by this section except to the extent that motor vehicle titles are governed by § 42-6-131, and the usage of the broad term "motor vehicle titles" indicates the legislative intent that whenever the question as to title to a motor vehicle arises with regard to a foreign security interest, the question is to be answered by application of § 42-6-131 and is precluded from the application of the provisions of § 4-9-103(3). Doenges-Glass, Inc. v. General Motors Acceptance Corp., 175 Colo. 518, 488 P.2d 879 (1971).

Code as enacted in New York determined validity and perfection of security interest. Where seller's only office is located in New York, and assignee of seller's accounts receivable is a New York corporation, the requirements of the uniform commercial code as enacted by New York determines the validity and perfection of assignee's security interest in accounts receivable. Barocas v. Bohemia Import Co., 33 Colo. App. 263, 518 P.2d 850 (1974).

The right to collect annual campground membership dues is a right to payment for services rendered, which is an ordinary commercial account receivable. If the security interest is in accounts, the law of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or nonperfection of the security interest. Therefore, since the

debtor was located at its place of business in Florida, Florida was the proper jurisdiction in which to file in order to perfect a security interest in the collateral, making the location of the collateral in Colorado irrelevant. Capitran Inc. v. Great Western Bank, 872 P.2d 1370 (Colo. App. 1994).

Farm combine which was type used by custom crop cutting in multi-state operations is mobile equipment within the meaning of § 4-9-103 (3)(a). Golden Plains Credit Union v. Konkel, 759 P.2d 788 (Colo. App. 1988), aff'd in part and rev'd in part, 778 P.2d 660 (Colo. 1989).

The provisions of this section and § 4-9-401 (1) are not mutually exclusive and, if equipment meets the requirements of both statutory provisions, it must be considered to fall into both categories. Golden Plains Credit Union v. Konkel, 759 P.2d 788 (Colo. App. 1988), aff'd in part and rev'd in part, 778 P.2d 660 (Colo. 1989).

4-9-302. Law governing perfection and priority of agricultural liens. While farm products are located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of an agricultural lien on the farm products.

Source: L. 2001: Entire article R&RE, p. 1342, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Agricultural Liens.** This section provides choice-of-law rules for agricultural liens on farm products. Perfection, the effect of perfection or nonperfection, and priority all are governed by the law of the jurisdiction in which the farm products are located. Other choice-of-law rules, including Section 1-105, determine which jurisdiction's law governs other matters, such as the secured party's rights on default. See Section 9-301, Comment 2. Inasmuch as no agricultural lien on proceeds arises under this Article, this section does not expressly apply to proceeds of agricultural liens. However, if another statute creates an agricultural lien on proceeds, it may be appropriate for courts to apply the choice-of-law rule in this section to determine priority in the proceeds.

Note: "Section 1-105," in the third sentence will be replaced with "Section 1-301," effective July 1, 2013.

4-9-303. Law governing perfection and priority of security interests in goods covered by a certificate of title. (a) This section applies to goods covered by a certificate of title, even if there is no other relationship between the jurisdiction under whose certificate of title the goods are covered and the goods or the debtor.

(b) Goods become covered by a certificate of title when a valid application for the certificate of title and the applicable fee are delivered to the appropriate authority. Goods cease to be covered by a certificate of title at the earlier of the time the certificate of title ceases to be effective under the law of the issuing jurisdiction or the time the goods become covered subsequently by a certificate of title issued by another jurisdiction.

(c) The local law of the jurisdiction under whose certificate of title the goods are covered governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in goods covered by a certificate of title from the time the goods become covered by the certificate of title until the goods cease to be covered by the certificate of title.

Source: L. 2001: Entire article R&RE, p. 1342, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-103 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-103(2)(a), (b), substantially revised.

2. **Scope of This Section.** This section applies to "goods covered by a certificate of title." The new definition of "certificate of title" in Section 9-102 makes clear that this section applies not only to certificate-of-title statutes under which perfection occurs upon notation of the

security interest on the certificate but also to those that contemplate notation but provide that perfection is achieved by another method, e.g., delivery of designated documents to an official. Subsection (a), which is new, makes clear that this section applies to certificates of a jurisdiction having no other contacts with the goods or the debtor. This result comports with most of the reported cases on the subject and with contemporary business practices in the trucking industry.

3. **Law Governing Perfection and Priority.** Subsection (c) is the basic choice-of-law rule for goods covered by a certificate of title. Perfection and priority of a security interest are governed by the law of the jurisdiction under whose certificate of title the goods are covered from the time the goods become covered by the certificate of title until the goods cease to be covered by the certificate of title.

Normally, under the law of the relevant jurisdiction, the perfection step would consist of compliance with that jurisdiction's certificate-of-title statute and a resulting notation of the security interest on the certificate of title. See Section 9-311(b). In the typical case of an automobile or over-the-road truck, a person who wishes to take a security interest in the vehicle can ascertain whether it is subject to any security interests by looking at the certificate of title. But certificates of title cover certain types of goods in some States but not in others. A secured party who does not realize this may extend credit and attempt to perfect by filing in the jurisdiction in which the debtor is located. If the goods had been titled in another jurisdiction, the lender would be unperfected.

Subsection (b) explains when goods become covered by a certificate of title and when they cease to be covered. Goods may become covered by a certificate of title, even though no certificate of title has issued. Former Section 9-103(2)(b) provided that the law of the jurisdiction issuing the certificate ceases to apply upon "surrender" of the certificate. This Article eliminates the concept of "surrender." However, if the certificate is surrendered in conjunction with an appropriate application for a certificate to be issued by another jurisdiction, the law of the original jurisdiction ceases to apply because the goods became covered subsequently by a certificate of title from another jurisdiction. Alternatively, the law of the original jurisdiction ceases to apply when the certificate "ceases to be effective" under the law of that jurisdiction. Given the diversity in certificate-of-title statutes, the term "effective" is not defined.

4. **Continued Perfection.** The fact that the law of one State ceases to apply under subsection (b) does not mean that a security interest perfected under that law becomes unperfected automatically. In most cases, the security interest will remain perfected. See Section 9-316(d), (e). Moreover, a perfected security interest may be subject to defeat by certain buyers and secured parties. See Section 9-337.

5. **Inventory.** Compliance with a certificate-of-title statute generally is *not* the method of perfecting security interests in inventory. Section 9-311(d) provides that a security interest created in inventory held by a person in the business of selling goods of that kind is subject to the normal filing rules; compliance with a certificate-of-title statute is not necessary or effective to perfect the security interest. Most certificate-of-title statutes are in accord.

The following example explains the subtle relationship between this rule and the choice-of-law rules in Section 9-303 and former Section 9-103(2):

Example: Goods are located in State A and covered by a certificate of title issued under the law of State A. The State A certificate of title is "clean"; it does not reflect a security interest. Owner takes the goods to State B and sells (trades in) the goods to Dealer, who is in the business of selling goods of that kind and is located (within the meaning of Section 9-307) in State B. As is customary, Dealer retains the duly assigned State A certificate of title pending resale of the goods. Dealer's inventory financer, SP, obtains a security interest in the goods under its after-acquired property clause.

Under Section 9-311(d) of both State A and State B, Dealer's inventory financer, SP, must perfect by filing instead of complying with a certificate-of-title statute. If Section 9-303 were read to provide that the law applicable to perfection of SP's security interest is that of State A, because the goods are covered by a State A certificate, then SP would be required to file in State A under State A's Section 9-501. That result would be anomalous, to say the least, since the principle underlying Section 9-311(d) is that the inventory should be treated as ordinary goods.

Section 9-303 (and former Section 9-103(2)) should be read as providing that the law of State B, not State A, applies. A court looking to the forum's Section 9- 303(a) would find that Section 9-303 applies only if two conditions are met: (i) the goods are covered by the certificate as explained in Section 9-303(b), i.e., application had been made for a State (here, State A) to issue a certificate of title covering the goods and (ii) the certificate is a "certificate of title" as defined in Section 9-102, i.e., "a statute provides for the security interest in question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor." Stated otherwise, Section 9-303 applies only when compliance with a certificate-of-title statute, and not filing, is the appropriate method of perfection. Under the law of State A, *for purposes of perfecting SP's security interest in the dealer's*

inventory, the proper method of perfection is filing not compliance with State A's certificate-of-title statute. For that reason, the goods are not covered by a "certificate of title," and the second condition is not met. Thus, Section 9-303 does not apply to the goods. Instead, Section 9-301 applies, and the applicable law is that of State B, where the debtor (dealer) is located.

6. **External Constraints on This Section.** The need to coordinate Article 9 with a variety of nonuniform certificate-of-title statutes, the need to provide rules to take account of situations in which multiple certificates of title are outstanding with respect to particular goods, and the need to govern the transition from perfection by filing in one jurisdiction to perfection by notation in another all create pressure for a detailed and complex set of rules. In an effort to minimize complexity, this Article does not attempt to coordinate Article 9 with the entire array of certificate-of-title statutes. In particular, Sections 9-303, 9-311, and 9-316(d) and (e) assume that the certificate-of-title statutes to which they apply do not have relation-back provisions (i.e., provisions under which perfection is deemed to occur at a time earlier than when the perfection steps actually are taken). A Legislative Note to Section 9-311 recommends the elimination of relation-back provisions in certificate-of-title statutes affecting perfection of security interests.

Ideally, at any given time, only one certificate of title is outstanding with respect to particular goods. In fact, however, sometimes more than one jurisdiction issues more than one certificate of title with respect to the same goods. This situation results from defects in certificate-of-title laws and the interstate coordination of those laws, not from deficiencies in this Article. As long as the possibility of multiple certificates of title remains, the potential for innocent parties to suffer losses will continue. At best, this Article can identify clearly which innocent parties will bear the losses in familiar fact patterns.

4-9-304. Law governing perfection and priority of security interests in deposit accounts. (a) The local law of a bank's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a deposit account maintained with that bank.

(b) The following rules determine a bank's jurisdiction for purposes of this part 3:

(1) If an agreement between the bank and its customer governing the deposit account expressly provides that a particular jurisdiction is the bank's jurisdiction for purposes of this part 3, this article, or this title, that jurisdiction is the bank's jurisdiction.

(2) If paragraph (1) of this subsection (b) does not apply and an agreement between the bank and its customer governing the deposit account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the bank's jurisdiction.

(3) If neither paragraph (1) nor paragraph (2) of this subsection (b) applies and an agreement between the bank and its customer governing the deposit account expressly provides that the deposit account is maintained at an office in a particular jurisdiction, that jurisdiction is the bank's jurisdiction.

(4) If none of paragraphs (1), (2), and (3) of this subsection (b) applies, the bank's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the customer's account is located.

(5) If none of paragraphs (1), (2), (3), and (4) of this subsection (b) applies, the bank's jurisdiction is the jurisdiction in which the chief executive office of the bank is located.

Source: L. 2001: Entire article R&RE, p. 1343, § 1, effective July 1. **L. 2002:** (b)(1) amended, p. 938, § 3, effective August 7..

OFFICIAL COMMENT

1. **Source.** New; derived from Section 8-110(e) and former Section 9-103(6).

2. **Deposit Accounts.** Under this section, the law of the "bank's jurisdiction" governs perfection and priority of a security interest in deposit accounts. Subsection (b) contains rules for determining the "bank's jurisdiction." The substance of these rules is substantially similar to that of the rules determining the "security intermediary's jurisdiction" under former Section 8-110(e), except that subsection (b)(1) provides more flexibility than the analogous provision in former Section 8-110(e)(1). Subsection (b)(1) permits the parties to choose the law of one jurisdiction to govern perfection and priority of security interests and a different governing law for other purposes. The parties' choice is effective, even if the jurisdiction whose law is chosen bears no relationship to the parties or the transaction. Section 8-110(e)(1) has been conformed to subsection (b)(1) of this section, and Section 9-305(b)(1), concerning a commodity interme-

diary's jurisdiction, makes a similar departure from former Section 9-103(6)(e)(i).

3. **Change in Law Governing Perfection.** When the bank's jurisdiction changes, the jurisdiction whose law governs perfection under subsection (a) changes, as well. Nevertheless, the change will not result in an immediate loss of perfection. See Section 9-316(f), (g).

4-9-305. Law governing perfection and priority of security interests in investment property. (a) Except as otherwise provided in subsection (c) of this section, the following rules apply:

(1) While a security certificate is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in the certificated security represented thereby.

(2) The local law of the issuer's jurisdiction as specified in section 4-8-110 (d) governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in an uncertificated security.

(3) The local law of the securities intermediary's jurisdiction as specified in section 4-8-110 (e) governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a security entitlement or securities account.

(4) The local law of the commodity intermediary's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a commodity contract or commodity account.

(b) The following rules determine a commodity intermediary's jurisdiction for purposes of this part 3:

(1) If an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that a particular jurisdiction is the commodity intermediary's jurisdiction for purposes of this part 3, this article, or this title, that jurisdiction is the commodity intermediary's jurisdiction.

(2) If paragraph (1) of this subsection (b) does not apply and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(3) If neither paragraph (1) nor paragraph (2) of this subsection (b) applies and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(4) If none of paragraphs (1), (2), and (3) of this subsection (b) applies, the commodity intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the commodity customer's account is located.

(5) If none of paragraphs (1), (2), (3), and (4) of this subsection (b) applies, the commodity intermediary's jurisdiction is the jurisdiction in which the chief executive office of the commodity intermediary is located.

(c) The local law of the jurisdiction in which the debtor is located governs:

(1) Perfection of a security interest in investment property by filing;

(2) Automatic perfection of a security interest in investment property created by a broker or securities intermediary; and

(3) Automatic perfection of a security interest in a commodity contract or commodity account created by a commodity intermediary.

Source: L. 2001: Entire article R&RE, p. 1343, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-103 (6) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-103(6).

2. **Investment Property: General Rules.** This section specifies choice-of-law rules for perfection and priority of security interests in investment property. Subsection (a)(1) covers security interests in certificated securities. Sub-

section (a)(2) covers security interests in uncertificated securities. Subsection (a)(3) covers security interests in security entitlements and securities accounts. Subsection (a)(4) covers security interests in commodity contracts and commodity accounts. The approach of each of these paragraphs is essentially the same. They identify the jurisdiction's law that governs questions of perfection and priority by using the same principles that Article 8 uses to determine other questions concerning that form of investment property. Thus, for certificated securities, the law of the jurisdiction in which the certificate is located governs. Cf. Section 8-110(c). For uncertificated securities, the law of the issuer's jurisdiction governs. Cf. Section 8-110(a). For security entitlements and securities accounts, the law of the securities intermediary's jurisdiction governs. Cf. Section 8-110(b). For commodity contracts and commodity accounts, the law of the commodity intermediary's jurisdiction governs. Because commodity contracts and commodity accounts are not governed by Article 8, subsection (b) contains rules that specify the commodity intermediary's jurisdiction. These are analogous to the rules in Section 8-110(e) specifying a securities intermediary's jurisdiction. Subsection (b)(1) affords the parties greater flexibility than did former Section 9-103(6)(3). See also Section 9-304(b) (bank's jurisdiction); Revised Section 8- 110(e)(1) (securities intermediary's jurisdiction).

3. **Investment Property: Exceptions.** Subsection (c) establishes an exception to the general rules set out in subsection (a). It provides that perfection of a security interest by filing, automatic perfection of a security interest in investment property created by a debtor who is a broker or securities intermediary (see Section 9-309(10)), and automatic perfection of a security interest in a commodity contract or commodity account of a debtor who is a commodity intermediary (see Section 9-309(11)) are governed by the law of the jurisdiction in which the debtor is located, as determined under Section 9-307.

4. **Examples:** The following examples illustrate the rules in this section:

Example 1: A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law but expressly provides that the law of California is Able's jurisdiction for purposes of the Uniform Commercial Code. Through the account the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer obtains a margin loan from Able. Subsection (a)(3) provides that California law the law of the securities intermediary's jurisdiction governs perfection and priority of the security interest, even if California has no other relationship to the parties or the transaction.

Example 2: A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer obtains a loan from a lender located in Illinois. The lender takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of Section 8-106(d)(2) to give the lender control. Subsection (a)(3) provides that Pennsylvania law the law of the securities intermediary's jurisdiction governs perfection and priority of the security interest, even if Pennsylvania has no other relationship to the parties or the transaction.

Example 3: A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account, the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer borrows from SP-1, and SP-1 files a financing statement in New Jersey. Later, the customer obtains a loan from SP-2. SP-2 takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of Section 8-106(d)(2) to give the SP-2 control. Subsection (c) provides that perfection of SP-1's security interest by filing is governed by the location of the debtor, so the filing in New Jersey was appropriate. Subsection (a)(3), however, provides that Pennsylvania law the law of the securities intermediary's jurisdiction governs all other questions of perfection and priority. Thus, Pennsylvania law governs perfection of SP-2's security interest, and Pennsylvania law also governs the priority of the security interests of SP-1 and SP-2.

5. **Change in Law Governing Perfection.** When the issuer's jurisdiction, the securities intermediary's jurisdiction, or commodity intermediary's jurisdiction changes, the jurisdiction whose law governs perfection under subsection (a) changes, as well. Similarly, the law governing perfection of a possessory security interest in a certificated security changes when the collateral is removed to another jurisdiction, see subsection (a)(1), and the law governing perfection by filing changes when the debtor changes its location. See subsection (c). Nevertheless, these changes will not result in an immediate loss of perfection. See Section 9-316.

Note: "(f), (g)" will be added to "Section 9-316." in the last sentence, effective July 1, 2013.

4-9-306. Law governing perfection and priority of security interests in letter-of-credit rights. (a) Subject to subsection (c) of this section, the local law of the issuer's jurisdiction or a nominated person's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a letter-of-credit right if the issuer's jurisdiction or nominated person's jurisdiction is a state.

(b) For purposes of this part 3, an issuer's jurisdiction or nominated person's jurisdiction is the jurisdiction whose law governs the liability of the issuer or nominated person with respect to the letter-of-credit right as provided in section 4-5-116.

(c) This section does not apply to a security interest that is perfected only under section 4-9-308 (d).

Source: L. 2001: Entire article R&RE, p. 1344, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New; derived in part from Section 8-110(e) and former Section 9-103(6).

2. ***Sui Generis Treatment.*** This section governs the applicable law for perfection and priority of security interests in letter-of-credit rights, other than a security interest perfected only under Section 9-308(d) (i.e., as a supporting obligation). The treatment differs substantially from that provided in Section 9-304 for deposit accounts. The basic rule is that the law of the issuer's or nominated person's (e.g., confirmer's) jurisdiction, derived from the terms of the letter of credit itself, controls perfection and priority, but only if the issuer's or nominated person's jurisdiction is a State, as defined in Section 9-102. If the issuer's or nominated person's jurisdiction is not a State, the baseline rule of Section 9-301 applies perfection and priority are governed by the law of the debtor's location, determined under Section 9-307. Export transactions typically involve a foreign issuer and a domestic nominated person, such as a confirmer, located in a State. The principal goal of this section is to reduce the likelihood that perfection and priority would be governed by the law of a foreign jurisdiction in a transaction that is essentially domestic from the standpoint of the debtor- beneficiary, its creditors, and a domestic nominated person.

3. **Issuer's or Nominated Person's Jurisdiction.** Subsection (b) defers to the rules established under Section 5-116 for determination of an issuer's or nominated person's jurisdiction.

Example: An Italian bank issues a letter of credit that is confirmed by a New York bank. The beneficiary is a Connecticut corporation. The letter of credit provides that the issuer's liability is governed by Italian law, and the confirmation provides that the confirmer's liability is governed by the law of New York. Under Sections 9-306(b) and 5-116(a), Italy is the issuer's jurisdiction and New York is the confirmer's (nominated person's) jurisdiction. Because the confirmer's jurisdiction is a State, the law of New York governs perfection and priority of a security interest in the beneficiary's letter-of-credit right against the confirmer. See Section 9-306(a). However, because the issuer's jurisdiction is not a State, the law of that jurisdiction does not govern. See Section 9-306(a). Rather, the choice-of-law rule in Section 9-301(1) applies to perfection and priority of a security interest in the beneficiary's letter-of-credit right against the issuer. Under that section, perfection and priority are governed by the law of the jurisdiction in which the debtor (beneficiary) is located. That jurisdiction is Connecticut. See Section 9-307.

4. **Scope of this Section.** This section specifies only the law governing perfection, the effect of perfection or nonperfection, and priority of security interests. Section 5-116 specifies the law governing the liability of, and Article 5 (or other applicable law) deals with the rights and duties of, an issuer or nominated person. Perfection, nonperfection, and priority have no effect on those rights and duties.

5. **Change in Law Governing Perfection.** When the issuer's jurisdiction, or nominated person's jurisdiction changes, the jurisdiction whose law governs perfection under subsection (a) changes, as well. Nevertheless, this change will not result in an immediate loss of perfection. See Section 9-316(f), (g).

4-9-307. Location of debtor. (a) In this section, "place of business" means a place where a debtor conducts its affairs.

(b) Except as otherwise provided in this section, the following rules determine a debtor's location:

(1) A debtor who is an individual is located at the individual's principal residence.

(2) A debtor that is an organization and has only one place of business is located at its place of business.

(3) A debtor that is an organization and has more than one place of business is located at its chief executive office.

(c) Subsection (b) of this section applies only if a debtor's residence, place of business, or chief executive office, as applicable, is located in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. If subsection (b) of this section does not apply, the debtor is located in the District of Columbia.

(d) A person that ceases to exist, have a residence, or have a place of business continues to be located in the jurisdiction specified by subsections (b) and (c) of this section.

(e) A registered organization that is organized under the law of a state is located in that state.

(f) Except as otherwise provided in subsection (i) of this section, a registered organization that is organized under the law of the United States and a branch or agency of a bank that is not organized under the law of the United States or a state are located:

(1) In the state that the law of the United States designates, if the law designates a state of location;

(2) In the state that the registered organization, branch, or agency designates, if the law of the United States authorizes the registered organization, branch, or agency to designate its state of location; or

Editor's note: This version of paragraph (2) is effective until July 1, 2013.

(2) In the state that the registered organization, branch, or agency designates, if the law of the United States authorizes the registered organization, branch, or agency to designate its state of location, including by designating its main office, home office, or other comparable office; or

Editor's note: This version of paragraph (2) is effective July 1, 2013.

(3) In the District of Columbia, if neither paragraph (1) nor paragraph (2) of this subsection (f) applies.

(g) A registered organization continues to be located in the jurisdiction specified by subsection (e) or (f) of this section notwithstanding:

(1) The suspension, revocation, forfeiture, or lapse of the registered organization's status as such in its jurisdiction of organization; or

(2) The dissolution, winding up, or cancellation of the existence of the registered organization.

(h) The United States is located in the District of Columbia.

(i) A branch or agency of a bank that is not organized under the law of the United States or a state is located in the state in which the branch or agency is licensed, if all branches and agencies of the bank are licensed in only one state.

(j) A foreign air carrier under the "Federal Aviation Act of 1958", as amended, is located at the designated office of the agent upon which service of process may be made on behalf of the carrier.

(k) This section applies only for purposes of this part 3.

Source: L. 2001: Entire article R&RE, p. 1345, § 1, effective July 1. **L. 2012:** (f)(2) amended, (HB 12-1262), ch. 170, p. 597, § 3, effective July 1, 2013.

Editor's note: This section is similar to former § 4-9-103 (3)(d) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-103(3)(d), substantially revised.

2. **General Rules.** As a general matter, the location of the debtor determines the jurisdiction

whose law governs perfection of a security interest. See Sections 9-301(1), 9-305(c). It also governs priority of a security interest in certain types of intangible collateral, such as accounts, electronic chattel paper, and general intangibles. This section determines the location of the debtor for choice-of-law purposes, but not for other purposes. See subsection (k).

Subsection (b) states the general rules: An individual debtor is deemed to be located at the individual's principal residence with respect to both personal and business assets. Any other debtor is deemed to be located at its place of business if it has only one, or at its chief executive office if it has more than one place of business.

As used in this section, a "place of business" means a place where the debtor conducts its affairs. See subsection (a). Thus, every organization, even eleemosynary institutions and other organizations that do not conduct "for profit" business activities, has a "place of business." Under subsection (d), a person who ceases to exist, have a residence, or have a place of business continues to be located in the jurisdiction determined by subsection (b).

The term "chief executive office" is not defined in this Section or elsewhere in the Uniform Commercial Code. "Chief executive office" means the place from which the debtor manages the main part of its business operations or other affairs. This is the place where persons dealing with the debtor would normally look for credit information, and is the appropriate place for filing. With respect to most multi-state debtors, it will be simple to determine which of the debtor's offices is the "chief executive office." Even when a doubt arises, it would be rare that there could be more than two possibilities. A secured party in such a case may protect itself by perfecting under the law of each possible jurisdiction.

Similarly, the term "principal residence" is not defined. If the security interest in question is a purchase-money security interest in consumer goods which is perfected upon attachment, see Section 9-309(1), the choice of law may make no difference. In other cases, when a doubt arises, prudence may dictate perfecting under the law of each jurisdiction that might be the debtor's "principal residence."

[Questions sometimes arise about the location of the debtor with respect to collateral held in a common-law trust. A typical common-law trust is not itself a juridical entity capable of owning property and so would not be a "debtor" as defined in Section 9-102. Rather, the debtor with respect to property held in a common-law trust typically is the trustee of the trust acting in the capacity of trustee. (The beneficiary would be a "debtor" with respect to its beneficial interest in the trust, but not with respect to the property held in the trust.) If a common-law trust has multiple trustees located in different jurisdictions, a secured party who perfects by filing would be well advised to file a financing statement in each jurisdiction in which a trustee is located, as determined under Section 9-307. Filing in all relevant jurisdictions would insure perfection and minimize any priority complications that otherwise might arise.]

Note: The bracketed language takes effect July 1, 2013.

The general rule is subject to several exceptions, each of which is discussed below.

Note: "rule is" will be replaced with "rules are" effective July 1, 2013.

3. **Non-U.S. Debtors.** Under the general rules of this section, a non-U.S. debtor normally would be located in a foreign jurisdiction and, as a consequence, foreign law would govern perfection. When foreign law affords no public notice of security interests, the general rule yields unacceptable results.

Accordingly, subsection (c) provides that the normal rules for determining the location of a debtor (i.e., the rules in subsection (b)) apply only if they yield a location that is "a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral." The phrase "generally requires" is meant to include legal regimes that generally require notice in a filing or recording system as a condition of perfecting nonpossessory security interests, but which permit perfection by another method (e.g., control, automatic perfection, temporary perfection) in limited circumstances. A jurisdiction that has adopted this Article or an earlier version of this Article is such a jurisdiction. If the rules in subsection (b) yield a jurisdiction whose law does not generally require notice in a filing or registration system [and none of the special rules in subsections (e), (f), (i), and (j) applies,] the debtor is located in the District of Columbia.

Note: The bracketed language takes effect July 1, 2013.

Example 1: Debtor is an English corporation with 7 offices in the United States and its chief executive office in London, England. Debtor creates a security interest in its accounts. Under subsection (b)(3), Debtor would be located in England. However, subsection (c) provides that subsection (b) applies only if English law generally conditions perfection on giving public notice in a filing, recording, or registration system. Otherwise, Debtor is located in the District of Columbia. Under Section 9-301(1), perfection, the effect of perfection, and priority are governed by the law of the jurisdiction of the debtor's location here, England or the District of

Columbia (depending on the content of English law).

Example 2: Debtor is an English corporation with 7 offices in the United States and its chief executive office in London, England. Debtor creates a security interest in equipment located in London. Under subsection (b)(3) Debtor would be located in England. However, subsection (c) provides that subsection (b) applies only if English law generally conditions perfection on giving public notice in a filing, recording, or registration system. Otherwise, Debtor is located in the District of Columbia. Under Section 9-301(1), perfection is governed by the law of the jurisdiction of the debtor's location, whereas, under Section 9-301(3), the law of the jurisdiction in which the collateral is located here, England governs priority.

The foregoing discussion assumes that each transaction bears an appropriate relation to the forum State. In the absence of an appropriate relation, the forum State's entire UCC, including the choice-of-law provisions in Article 9 (Sections 9-301 through 9-307), will not apply. See Section 9-109, Comment 9.

4. **Registered Organizations Organized Under Law of a State.** Under subsection (e), a registered organization (e.g., a corporation or limited partnership) organized under the law of a "State" (defined in Section 9-102) is located in its State of organization.

Note: This version of this paragraph is effective until July 1, 2013.

Under subsection (e), a "registered organization" (defined in Section 9-102 so as to ordinarily include corporations, limited partnerships, limited liability companies, and statutory trusts) organized under the law of a "State" (defined in Section 9-102) is located in its State of organization. The term "registered organization" includes a business trust described in the second sentence of the term's definition. See Section 9-102. The trust's public organic record, typically the trust agreement, usually will indicate the jurisdiction under whose law the trust is organized.

Note: This version of this paragraph takes effect July 1, 2013.

Subsection (g) makes clear that events affecting the status of a registered organization, such as the dissolution of a corporation or revocation of its charter, do not affect its location for purposes of subsection (e). However, certain of these events may result in, or be accompanied by, a transfer of collateral from the registered organization to another debtor. This section does not determine whether a transfer occurs, nor does it determine the legal consequences of any transfer.

Determining the registered organization-debtor's location by reference to the jurisdiction of organization could provide some important side benefits for the filing systems. A jurisdiction could structure its filing system so that it would be impossible to make a mistake in a registered organization-debtor's name on a financing statement. For example, a filer would be informed if a filed record designated an incorrect corporate name for the debtor. Linking filing to the jurisdiction of organization also could reduce pressure on the system imposed by transactions in which registered organizations cease to exist as a consequence of merger or consolidation, for example. The jurisdiction of organization might prohibit such transactions unless steps were taken to ensure that existing filings were refiled against a successor or terminated by the secured party.

5. **Registered Organizations Organized Under Law of United States; Branches and Agencies of Banks Not Organized Under Law of United States.** Subsection (f) specifies the location of a debtor that is a registered organization organized under the law of the United States. It defers to the law of the United States, to the extent that that law determines, or authorizes the debtor to determine, the debtor's location. Thus, if the law of the United States designates a particular State as the debtor's location, that State is the debtor's location for purposes of this Article's choice-of-law rules. Similarly, if the law of the United States authorizes the registered organization to designate its State of location, the State that the registered organization designates is the State in which it is located for purposes of this Article's choice-of-law rules. In other cases, the debtor is located in the District of Columbia.

In some cases, the law of the United States authorizes the registered organization to designate a main office, home office, or other comparable office. See, e.g., 12 U.S.C. 22 and 1464(a); 12 C.F.R. 552.3. Designation of such an office constitutes the designation of the State of location for purposes of Section 9-307(f)(2).

Subsection (f) also specifies the location of a branch or agency in the United States of a foreign bank that has one or more branches or agencies in the United States. The law of the United States authorized a foreign bank (or, on behalf of the bank, a federal regulatory agency) to designate a single home state for all of the foreign bank's branches and agencies in the United States. See 12 U.S.C. 3103(c) and 12 C.F.R. 211.22. The designated State constitutes the State of location for the branch or agency for purposes of Section 9-307(f); however, if all of the foreign bank's branches or agencies that are in the United States are licensed in only one State, the branches and agencies are located in that State. See subsection (i).

Note: "authorized" in the second sentence will be replaced with "authorizes", effective July 1, 2013.

In cases not governed by subsection (f) or (i), the location of a foreign bank is determined by subsections (b) and (c).

Subsection (f) also determines the location of branches and agencies of banks that are not organized under the law of the United States or a State. However, if all the branches and agencies of the bank are licensed only in one State, then they are located in that State. See subsection (i).

6. **United States.** To the extent that Article 9 governs (see Sections 1-105, 9-109(c)), the United States is located in the District of Columbia for purposes of this Article's choice-of-law rules. See subsection (h).

Note: "Sections 1-105," will be replaced with "Sections 1-301," effective July 1, 2013.

7. **Foreign Air Carriers.** Subsection (j) follows former Section 9-103(3)(d). To the extent that it is applicable, the Convention on the International Recognition of Rights in Aircraft (Geneva Convention) supersedes state legislation on this subject, as set forth in Section 9-311(b), but some nations are not parties to that Convention.

4-9-308. When security interest or agricultural lien is perfected - continuity of perfection. (a) Except as otherwise provided in this section and section 4-9-309, a security interest is perfected if it has attached and all of the applicable requirements for perfection in sections 4-9-310 to 4-9-316 have been satisfied. A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.

(b) An agricultural lien is perfected if it has become effective and all of the applicable requirements for perfection in section 4-9-310 have been satisfied. An agricultural lien is perfected when it becomes effective if the applicable requirements are satisfied before the agricultural lien becomes effective.

(c) A security interest or agricultural lien is perfected continuously if it is originally perfected by one method under this article and is later perfected by another method under this article, without an intermediate period when it was unperfected.

(d) Perfection of a security interest in collateral also perfects a security interest in a supporting obligation for the collateral.

(e) Perfection of a security interest in a right to payment or performance also perfects a security interest in a security interest, mortgage, or other lien on personal or real property securing the right.

(f) Perfection of a security interest in a securities account also perfects a security interest in the security entitlements carried in the securities account.

(g) Perfection of a security interest in a commodity account also perfects a security interest in the commodity contracts carried in the commodity account.

Source: L. 2001: Entire article R&RE, p. 1346, § 1, effective July 1.

Editor's note: The provisions of this section are similar to former §§ 4-9-115 (2) and 4-9-303 as they existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Sections 9-303, 9-115(2).

2. **General Rule.** This Article uses the term "attach" to describe the point at which property becomes subject to a security interest. The requisites for attachment are stated in Section 9-203. When it attaches, a security interest may be either perfected or unperfected. "Perfected" means that the security interest has attached and the secured party has taken all the steps required by this Article as specified in Sections 9-310 through 9-316. A perfected security interest may still be or become subordinate to other interests. See, e.g., Sections 9-320, 9-322. However, in general, after perfection the secured party is protected against creditors and transferees of the debtor and, in particular, against any representative of creditors in insolvency proceedings instituted by or against the debtor. See, e.g., Section 9-317.

Subsection (a) explains that the time of perfection is when the security interest has attached and any necessary steps for perfection, such as taking possession or filing, have been taken. The "except" clause refers to the perfection-upon-attachment rules appearing in Section 9-309. It also reflects that other subsections of this section, e.g., subsection (d), contain automatic-perfection rules. If the steps for perfection have been taken in advance, as when the secured party files a financing statement before giving

value or before the debtor acquires rights in the collateral, then the security interest is perfected when it attaches.

3. **Agricultural Liens.** Subsection (b) is new. It describes the elements of perfection of an agricultural lien.

4. **Continuous Perfection.** The following example illustrates the operation of subsection (c):

Example 1: Debtor, an importer, creates a security interest in goods that it imports and the documents of title that cover the goods. The secured party, Bank, takes possession of a negotiable bill of lading covering certain imported goods and thereby perfects its security interest in the bill of lading and the goods. See Sections 9-313(a), 9-312(c)(1). Bank releases the bill of lading to the debtor for the purpose of procuring the goods from the carrier and selling them. Under Section 9-312(f), Bank continues to have a perfected security interest in the document and goods for 20 days. Bank files a financing statement covering the collateral before the expiration of the 20-day period. Its security interest now continues perfected for as long as the filing is good.

If the successive stages of Bank's security interest succeed each other without an intervening gap, the security interest is "perfected continuously," and the date of perfection is when the security interest first became perfected (i.e., when Bank received possession of the bill of lading). If, however, there is a gap between stages for example, if Bank does not file until after the expiration of the 20-day period specified in Section 9-312(f) and leaves the collateral in the debtor's possession then, the chain being broken, the perfection is no longer continuous. The date of perfection would now be the date of filing (after expiration of the 20-day period). Bank's security interest would be vulnerable to any interests arising during the gap period which under Section 9-317 take priority over an unperfected security interest.

5. **Supporting Obligations.** Subsection (d) is new. It provides for automatic perfection of a security interest in a supporting obligation for collateral if the security interest in the collateral is perfected. This is unlikely to effect any change in the law prior to adoption of this Article.

Example 2: Buyer is obligated to pay Debtor for goods sold. Buyer's president guarantees the obligation. Debtor creates a security interest in the right to payment (account) in favor of Lender. Under Section 9-203(f), the security interest attaches to Debtor's rights under the guarantee (supporting obligation). Under subsection (d), perfection of the security interest in the account constitutes perfection of the security interest in Debtor's rights under the guarantee.

6. **Rights to Payment Secured by Lien.** Subsection (e) is new. It deals with the situation in which a security interest is created in a right to payment that is secured by a security interest, mortgage, or other lien.

Example 3: Owner gives to Mortgagee a mortgage on Blackacre to secure a loan. Owner's obligation to pay is evidenced by a promissory note. In need of working capital, Mortgagee borrows from Financer and creates a security interest in the note in favor of Financer. Section 9-203(g) adopts the traditional view that the mortgage follows the note; i.e., the transferee of the note acquires the mortgage, as well. This subsection adopts a similar principle: perfection of a security interest in the right to payment constitutes perfection of a security interest in the mortgage securing it.

An important consequence of the rules in Section 9-203(g) and subsection (e) is that, by acquiring a perfected security interest in a mortgage (or other secured) note, the secured party acquires a security interest in the mortgage (or other lien) that is senior to the rights of a person who becomes a lien creditor of the mortgagee (Article 9 debtor). See Section 9-317(a)(2). This result helps prevent the separation of the mortgage (or other lien) from the note.

Under this Article, attachment and perfection of a security interest in a secured right to payment do not of themselves affect the obligation to pay. For example, if the obligation is evidenced by a negotiable note, then Article 3 dictates the person whom the maker must pay to discharge the note and any lien securing it. See Section 3-602. If the right to payment is a payment intangible, then Section 9-406 determines whom the account debtor must pay.

Similarly, this Article does not determine who has the power to release a mortgage of record. That issue is determined by real-property law.

7. **Investment Property.** Subsections (f) and (g) follow former Section 9-115(2).

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "A Practical Checklist for Buying or Selling a Small Business in Colorado", see 15 Colo. Law. 2171 (1986).

Annotator's note. Since § 4-9-308 is similar to § 4-9-303 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

For perfection to obtain at all, a security interest must first attach. Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976).

Under certain circumstances, an unjust enrichment claim will prevail over a properly perfected security interest under this article. Duggan, Inc. v. Ninth Dist. Prod. Credit Ass'n, 795 P.2d 1347 (Colo. App. 1990), rev'd on other grounds, 821 P.2d 788 (Colo. 1991).

4-9-309. Security interest perfected upon attachment. The following security interests are perfected when they attach:

(1) A purchase-money security interest in consumer goods, except as otherwise provided in section 4-9-311 (b) with respect to consumer goods that are subject to a statute or treaty described in section 4-9-311 (a);

(2) An assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles;

(3) A sale of a payment intangible;

(4) A sale of a promissory note;

(5) A security interest created by the assignment of a health-care-insurance receivable to the provider of the health-care goods or services;

(6) A security interest arising under section 4-2-401, 4-2-505, 4-2-711 (3), or 4-2.5-508 (5), until the debtor obtains possession of the collateral;

(7) A security interest of a collecting bank arising under section 4-4-210;

(8) A security interest of an issuer or nominated person arising under section 4-5-117.5;

(9) A security interest arising in the delivery of a financial asset under section 4-9-206 (c);

(10) A security interest in investment property created by a broker or securities intermediary;

(11) A security interest in a commodity contract or a commodity account created by a commodity intermediary;

(12) An assignment for the benefit of all creditors of the transferor and subsequent transfers by the assignee thereunder;

(13) A security interest created by an assignment of a beneficial interest in a decedent's estate; and

(14) A sale by an individual of an account that is a right to payment of winnings in a lottery or other game of chance.

Source: L. 2001: Entire article R&RE, p. 1347, § 1, effective July 1. **L. 2002:** (14) added, p. 938, § 4, effective August 7.

Editor's note: (1) The provisions of this section are similar to provisions of several former sections as they existed prior to 2001. For a detailed comparison, see the comparative tables located in the back of the index.

(2) **Colorado legislative change:** Colorado substituted the reference to § 4-5-117.5 for the uniform act's reference to § 4-5-118 in paragraph (8).

OFFICIAL COMMENT

1. **Source.** Derived from former Sections 9-302(1), 9-115(4)(c), (d), 9-116.

2. **Automatic Perfection.** This section contains the perfection-upon-attachment rules previously located in former Sections 9-302(1), 9-115(4)(c), (d), and 9-116. Rather than continue to state the rule by indirection, this section explicitly provides for perfection upon attachment.

3. **Purchase-Money Security Interest in Consumer Goods.** Former Section 9-302(1)(d) has been revised and appears here as paragraph (1). No filing or other step is required to perfect a purchase-money security interest in consumer goods, other than goods, such as automobiles, that are subject to a statute or treaty described in Section 9-311(a). However, filing is required to perfect a non-purchase-money security interest in consumer goods and is necessary to prevent a buyer of consumer goods from taking free of a security interest under Section 9-320(b). A fixture filing is required for priority over conflicting interests in fixtures to the extent provided in Section 9-334.

4. **Rights to Payment.** Paragraph (2) expands upon former Section 9-302(1)(e) by affording automatic perfection to certain assignments of payment intangibles as well as accounts. The purpose of paragraph (2) is to save from *ex post facto* invalidation casual or isolated assignments which no one would think of filing. Any person who regularly takes assignments of any debtor's accounts or payment intangibles should file. In this connection Section 9-109(d)(4) through (7), which excludes certain transfers of accounts, chattel paper, payment intangibles, and promissory notes from this Article, should be consulted.

Paragraphs (3) and (4), which are new, afford automatic perfection to sales of payment intangibles and promissory notes, respectively. They reflect the practice under former Article 9. Under that Article, filing a financing statement did not affect the rights of a buyer of payment intangibles or promissory notes, inasmuch as the former Article did not cover those sales. To the extent that the exception in paragraph (2) covers outright sales of payment intangibles, which automatically are perfected under paragraph (3), the exception is redundant.

5. **Health-Care-Insurance Receivables.** Paragraph (5) extends automatic perfection to assignments of health-care-insurance receivables if the assignment is made to the health-care provider that provided the health-care goods or services. The primary effect is that, when an individual assigns a right to payment under an insurance policy to the person who provided health-care goods or services, the provider has no need to file a financing statement against the individual. The normal filing requirements apply to other assignments of health-care-insurance receivables covered by this Article, e.g., assignments from the health-care provider to a financer.

6. **Investment Property.** Paragraph (9) replaces the last clause of former Section 9-116(2), concerning security interests that arise in the delivery of a financial asset.

Paragraphs (10) and (11) replace former Section 9-115(4)(c) and (d), concerning secured financing of securities and commodity firms and clearing corporations. The former sections indicated that, with respect to certain security interests created by a securities intermediary or commodity intermediary, "[t]he filing of a financing statement . . . has no effect for purposes of perfection or priority with respect to that security interest." No change in meaning is intended by the deletion of the quoted phrase.

Secured financing arrangements for securities firms are currently implemented in various ways. In some circumstances, lenders may require that the transactions be structured as "hard pledges," where the securities are transferred on the books of a clearing corporation from the debtor's account to the lender's account or to a special pledge account for the lender where they cannot be disposed of without the specific consent of the lender. In other circumstances, lenders are content with so-called "agreement to pledge" or "agreement to deliver" arrangements, where the debtor retains the positions in its own account, but reflects on its books that the positions have been hypothecated and promises that the securities will be transferred to the secured party's account on demand.

The perfection and priority rules of this Article are designed to facilitate current secured financing arrangements for securities firms as well as to provide sufficient flexibility to accommodate new arrangements that develop in the future. Hard pledge arrangements are covered by the concept of control. See Sections 9-314, 9-106, 8-106. Non-control secured financing arrangements for securities firms are covered by the automatic perfection rule of paragraph (10). Before the 1994 revision of Articles 8 and 9, agreement to pledge arrangements could be implemented under a provision that a security interest in securities given for new value under a written security agreement was perfected without filing or possession for a period of 21 days. Although the security interests were temporary in legal theory, the financing arrangements could, in practice, be continued indefinitely by rolling over the loans at least every 21 days. Accordingly, a knowledgeable creditor of a securities firm realizes that the firm's securities may be subject to security interests that are not discoverable from any public records. The automatic-perfection rule of paragraph (10) makes it unnecessary to engage in the purely formal practice of rolling over these arrangements every 21 days.

In some circumstances, a clearing corporation may be the debtor in a secured financing arrangement. For example, a clearing corporation that settles delivery-versus-payment transactions among its participants on a net, same-day basis relies on timely payments from all participants with net obligations due to the system. If a participant that is a net debtor were to default on its payment obligation, the clearing corporation would not receive some of the funds needed to settle with participants that are net creditors to the system. To complete end-of-day settlement after a payment default by a participant, a clearing corporation that settles on a net, same-day basis may need to draw on credit lines and pledge securities of the defaulting participant or other securities pledged by participants in the clearing corporation to secure such drawings. The clearing corporation may be the top-tier securities intermediary for the securities pledged, so that it would not be practical for the lender to obtain control. Even where the clearing corporation holds some types of securities through other intermediaries, however, the clearing corporation is unlikely to be able to

complete the arrangements necessary to convey "control" over the securities to be pledged in time to complete settlement in a timely manner. However, the term "securities intermediary" is defined in Section 8-102(a)(14) to include clearing corporations. Thus, the perfection rule of paragraph (10) applies to security interests in investment property granted by clearing corporations.

7. **Beneficial Interests in Trusts.** Under former Section 9-302(1)(c), filing was not required to perfect a security interest created by an assignment of a beneficial interest in a trust. Because beneficial interests in trusts are now used as collateral with greater frequency in commercial transactions, under this Article filing is required to perfect a security interest in a beneficial interest.

8. **Assignments for Benefit of Creditors.** No filing or other action is required to perfect an assignment for the benefit of creditors. These assignments are not financing transactions, and the debtor ordinarily will not be engaging in further credit transactions.

Paragraph (14), which is new, affords automatic perfection to sales by individuals of an "account" (as defined in Section 9-102) consisting of the right to winnings in a lottery or other game of chance. Payments on these accounts typically extend for periods of twenty years or more. It would be unduly burdensome for the secured party, who would have no other reason to maintain contact with the seller, to monitor the seller's whereabouts for such a length of time. This paragraph was added in 2001. It applies to a sale of an account described in it, even if the sale was entered into before the effective date of the paragraph. However, if the relative priorities of conflicting claims to the account were established before the paragraph took effect, Article 9 as in effect immediately prior to the date the paragraph took effect determines priority.

4-9-310. When filing required to perfect security interest or agricultural lien - security interests and agricultural liens to which filing provisions do not apply. (a) Except as otherwise provided in subsection (b) of this section and section 4-9-312 (b), a financing statement must be filed to perfect all security interests and agricultural liens.

(b) The filing of a financing statement is not necessary to perfect a security interest:

(1) That is perfected under section 4-9-308 (d), (e), (f), or (g);

(2) That is perfected under section 4-9-309 when it attaches;

(3) In property subject to a statute, regulation, or treaty described in section 4-9-311 (a);

(4) In goods in possession of a bailee which is perfected under section 4-9-312 (d) (1) or (2);

(5) In certificated securities, documents, goods, or instruments that is perfected without filing, control, or possession under section 4-9-312 (e), (f), or (g);

(6) In collateral in the secured party's possession under section 4-9-313;

(7) In a certificated security which is perfected by delivery of the security certificate to the secured party under section 4-9-313;

(8) In deposit accounts, electronic chattel paper, electronic documents, investment property, or letter-of-credit rights that is perfected by control under section 4-9-314;

(9) In proceeds which is perfected under section 4-9-315; or

(10) That is perfected under section 4-9-316.

(c) If a secured party assigns a perfected security interest or agricultural lien, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

Source: L. 2001: Entire article R&RE, p. 1348, § 1, effective July 1. **L. 2006:** (b)(5) and (b)(8) amended, p. 501, § 38, effective September 1.

Editor's note: This section is similar to former § 4-9-302 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-302(1), (2).

2. **General Rule.** Subsection (a) establishes a central Article 9 principle: Filing a financing statement is necessary for perfection of security interests and agricultural liens. However, filing is not necessary to perfect a security interest that is perfected by another permissible method, see subsection (b), nor does filing ordinarily perfect a security interest in a deposit account, letter-of-credit right, or money. See Section 9-312(b).

Part 5 of the Article deals with the office in which to file, mechanics of filing, and operations of the filing office.

3. **Exemptions from Filing.** Subsection (b) lists the security interests for which filing is not required as a condition of perfection, because they are perfected automatically upon attachment (subsections (b)(2) and (b)(9)) or upon the occurrence of another event (subsections (b)(1), (b)(5), and (b)(9)), because they are perfected under the law of another jurisdiction (subsection (b)(10)), or because they are perfected by another method, such as by the secured party's taking possession or control (subsections (b)(3), (b)(4), (b)(5), (b)(6), (b)(7), and (b)(8)).

4. **Assignments of Perfected Security Interests.** Subsection (c) concerns assignment of a perfected security interest or agricultural lien. It provides that no filing is necessary in connection with an assignment by a secured party to an assignee in order to maintain perfection as against creditors of and transferees from the original debtor.

Example 1: Buyer buys goods from Seller, who retains a security interest in them. After Seller perfects the security interest by filing, Seller assigns the perfected security interest to X. The security interest, in X's hands and without further steps on X's part, continues perfected against *Buyer's* transferees and creditors.

Example 2: Dealer creates a security interest in specific equipment in favor of Lender. After Lender perfects the security interest in the equipment by filing, Lender assigns the chattel paper (which includes the perfected security interest in Dealer's equipment) to X. The security interest in the equipment, in X's hands and without further steps on X's part, continues perfected against *Dealer's* transferees and creditors. However, regardless of whether Lender made the assignment to secure Lender's obligation to X or whether the assignment was an outright sale of the chattel paper, the assignment creates a security interest in the chattel paper in favor of X. Accordingly, X must take whatever steps may be required for perfection in order to be protected against *Lender's* transferees and creditors with respect to the chattel paper.

Subsection (c) applies not only to an assignment of a security interest perfected by filing but also to an assignment of a security interest perfected by a method other than by filing, such as by control or by possession. Although subsection (c) addresses explicitly only the absence of an additional filing requirement, the same result normally will follow in the case of an assignment of a security interest perfected by a method other than by filing. For example, as long as possession of collateral is maintained by an assignee or by the assignor or another person on behalf of the assignee, no further perfection steps need be taken on account of the assignment to continue perfection as against creditors and transferees of the original debtor. Of course, additional action may be required for perfection of the assignee's interest as against creditors and transferees of the *assignor*.

Similarly, subsection (c) applies to the assignment of a security interest perfected by compliance with a statute, regulation, or treaty under Section 9-311(b), such as a certificate-of-title statute. Unless the statute expressly provides to the contrary, the security interest will remain perfected against creditors of and transferees from the original debtor, even if the assignee takes no action to cause the certificate of title to reflect the assignment or to cause its name to appear on the certificate of title. See PEB Commentary No. 12, which discusses this issue under former Section 9-302(3). Compliance with the statute is "equivalent to filing" under Section 9-311(b).

ANNOTATION

Law reviews. For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For comment on In re Lehner appearing below, see 48 Den. L.J. 146 (1971). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

Annotator's note. Since § 4-9-310 is similar to § 4-9-302 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

A financing statement must be filed to perfect all security interests, with some exceptions. In re Lehner, 303 F. Supp. 317 (D. Colo. 1969), aff'd per curiam and reh'g denied, 427 F.2d 357 (10th Cir. 1970).

Assignment of proceeds to be paid in condemnation proceeding is not perfected lien, entitled to priority, until a financing statement is filled pursuant to this section. Bd. of County Comm'rs v. Berkeley Vill., 40 Colo. App. 431, 580 P.2d 1251 (1978).

Because priority of perfected security interest in crops depends upon date of its filing, it will normally have priority under "first in time" rule over creditor's "rents and profits" clause in a deed of trust because there priority is determined by time of application for receivership. Application of Northwestern Mut. Life Ins. Co., 703 P.2d 1314 (Colo. App. 1985).

Such as logging equipment. For security interests in logging equipment to be perfected, a

financing statement must be properly filed. Mountain Credit v. Michiana Lumber & Supply, Inc., 31 Colo. App. 112, 498 P.2d 967 (1972).

A security interest in general intangibles, including the settlement of a lawsuit, is perfected by filing a financing statement as provided by law, which gives the holder of the perfected security interest a superior interest as creditor in the settlement proceeds over a judgment creditor who becomes a lien creditor only when the writ of garnishment is served on the debtor. Bowlen v. Federal Deposit Insurance Corp., 815 P.2d 1013 (Colo. App. 1991).

Applied in Welbourne Dev. Co. v. Affiliated Clearance Corp., 28 Colo. App. 313, 472 P.2d 684 (1970); Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977); Yeager Trucking v. Circle Leasing, 29 Bankr. 131 (Bankr. D. Colo. 1983).

4-9-311. Perfection of security interests in property subject to certain statutes, regulations, and treaties. (a) Except as otherwise provided in subsection (d) of this section, the filing of a financing statement is not necessary or effective to perfect a security interest in property subject to:

(1) A statute, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt section 4-9-310 (a);

(2) A certificate-of-title statute of this state covering automobiles or other goods, which provides for a security interest to be indicated on the certificate as a condition or result of perfection of the security interest; or

Editor's note: This version of paragraph (2) is effective until July 1, 2013.

(2) A statute of this state covering automobiles or other goods that provides for a security interest to be indicated on a certificate of title as a condition or result of perfection of the security interest; or

Editor's note: This version of paragraph (2) is effective July 1, 2013.

(3) A certificate-of-title statute of another jurisdiction which provides for a security interest to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the property.

Editor's note: This version of paragraph (3) is effective until July 1, 2013.

(3) A statute of another jurisdiction that provides for a security interest to be indicated on a certificate of title as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the property.

Editor's note: This version of paragraph (3) is effective July 1, 2013.

(b) Compliance with the requirements of a statute, regulation, or treaty described in subsection (a) of this section for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under this article. Except as otherwise provided in subsection (d) of this section and sections 4-9-313 and 4-9-316 (d) and (e) for goods covered by a certificate of title, a security interest in property subject to a statute, regulation, or treaty described in subsection (a) of this section may be perfected only by compliance with those requirements, and a security interest so perfected remains perfected notwithstanding a change in the use or transfer of possession of the collateral.

(c) Except as otherwise provided in subsection (d) of this section and section 4-9-316 (d) and (e), duration and renewal of perfection of a security interest perfected by compliance with the requirements prescribed by a statute, regulation, or treaty described in subsection (a) of this section are governed by the statute, regulation, or treaty. In other respects, the security interest is subject to this article.

(d) During any period in which collateral subject to a statute specified in paragraph (2) of subsection (a) of this section is inventory held for sale or lease by a person or leased by that person as lessor and that person is in the business of selling goods of that kind, this section does not apply to a security interest in that collateral created by that person.

Source: L. 2001: Entire article R&RE, p. 1348, § 1, effective July 1. **L. 2012:** (a)(2) and (a)(3) amended, (HB 12-1262), ch. 170, p. 597, § 4, effective July 1, 2013.

Editor's note: (1) This section is similar to former § 4-9-302 as it existed prior to 2001.

(2) **Colorado legislative change:** In subsection (d), Colorado added the phrase "subject to a statute specified in paragraph (2) of subsection (a) of this section" and did not adopt the phrase "or leasing" after the word "selling" or the phrase "as debtor" at the end of the sentence.

OFFICIAL COMMENT

1. **Source.** Former Section 9-302(3), (4).

2. **Federal Statutes, Regulations, and Treaties.** Subsection (a)(1) exempts from the filing provisions of this Article transactions as to which a system of filing state or federal has been established under federal law. Subsection (b) makes clear that when such a system exists, perfection of a relevant security interest can be achieved only through compliance with that system (i.e., filing under this Article is not a permissible alternative).

An example of the type of federal statute referred to in subsection (a)(1) is 49 U.S.C. §§ 44107-11, for civil aircraft of the United States. The Assignment of Claims Act of 1940, as amended, provides for notice to contracting and disbursing officers and to sureties on bonds but does not establish a national filing system and therefore is not within the scope of subsection (a)(1). An assignee of a claim against the United States may benefit from compliance with the Assignment of Claims Act. But regardless of whether the assignee complies with that Act, the assignee must file under this Article in order to perfect its security interest against creditors and transferees of its assignor.

Subsection (a)(1) provides explicitly that the filing requirement of this Article defers only to federal statutes, regulations, or treaties whose requirements for a security interest's obtaining priority over the rights of a lien creditor preempt Section 9-310(a). The provision eschews reference to the term "perfection," inasmuch as Section 9-308 specifies the meaning of that term and a preemptive rule may use other terminology.

3. **State Statutes.** Subsections (a)(2) and (3) exempt from the filing requirements of this Article transactions covered by State certificate-of-title statutes covering motor vehicles and the like. The description of certificate-of-title statutes in subsections (a)(2) and (a)(3) tracks the language of the definition of "certificate of title" in Section 9-102. For a discussion of the operation of state certificate-of-title statutes in interstate contexts, see the Comments to Section 9-303.

Some states have enacted central filing statutes with respect to secured transactions in kinds of property that are of special importance in the local economy. Subsection (a)(2) defers to these statutes with respect to filing for that property.

4. **Inventory Covered by Certificate of Title.** Under subsection (d), perfection of a security interest in the inventory of a person in the business of selling goods of that kind is governed by the normal perfection rules, even if the inventory is subject to a certificate-of-title statute. Compliance with a certificate-of-title statute is both unnecessary and ineffective to perfect a security interest in inventory to which this subsection applies. Thus, a secured party who finances an automobile dealer that is in the business of selling and leasing its inventory of automobiles can perfect a security interest in all the automobiles by filing a financing statement but not by compliance with a certificate-of-title statute.

Subsection (d), and thus the filing and other perfection provisions of this Article, does not apply to inventory that is subject to a certificate-of-title statute and is of a kind that the debtor is not in the business of selling. For example, if goods are subject to a certificate-of-title statute and the debtor is in the business of leasing but not of selling, goods of that kind, the other subsections of this section govern perfection of a security interest in the goods. The fact that the debtor eventually sells the goods does not, of itself, mean that the debtor "is in the business of selling goods of that kind."

The filing and other perfection provisions of this Article apply to goods subject to a certificate-of-title statute only "during any period in which collateral is inventory held for sale or lease or leased." If the debtor takes goods of this kind out of inventory and uses them, say, as equipment, a filed financing statement would not remain effective to perfect a security interest.

5. **Compliance with Perfection Requirements of Other Statute.** Subsection (b) makes clear that compliance with the perfection requirements (i.e., the requirements for obtaining priority over a lien creditor), but not other requirements, of a statute, regulation, or treaty described in subsection (a) is sufficient for perfection under this Article. Perfection of a security interest under such a statute, regulation, or treaty has all the consequences of perfection under this Article.

The interplay of this section with certain certificate-of-title statutes may create confusion and uncertainty. For example, statutes under which perfection does not occur until a certificate of title is issued will create a gap between the time that the goods are covered by the certificate under Section 9-303 and the time of perfection. If the gap is long enough, it may result in turning some unobjectionable transac-

tions into avoidable preferences under Bankruptcy Code Section 547. (The preference risk arises if more than [10 days (or 20 days, in the case of a purchase-money security interest)] passes between the time a security interest attaches (or the debtor receives possession of the collateral, in the case of a purchase-money security interest) and the time it is perfected.) Accordingly, the Legislative Note to this section instructs the legislature to amend the applicable certificate-of-title statute to provide that perfection occurs upon receipt by the appropriate State official of a properly tendered application for a certificate of title on which the security interest is to be indicated.

Note: "10 days (or 20 days, in the case of a purchase-money security interest)" in the third sentence will be replaced with "30 days", effective July 1, 2013.

Under some certificate-of-title statutes, including the Uniform Motor Vehicle Certificate of Title and Anti-Theft Act, perfection generally occurs upon delivery of specified documents to a state official but may, under certain circumstances, relate back to the time of attachment. This relation-back feature can create great difficulties for the application of the rules in Sections 9-303 and 9-311(b). Accordingly, the Legislative Note also recommends to legislatures that they remove any relation-back provisions from certificate-of-title statutes affecting security interests.

6. **Compliance with Perfection Requirements of Other Statute as Equivalent to Filing.** Under Subsection (b), compliance with the perfection requirements (i.e., the requirements for obtaining priority over a lien creditor) of a statute, regulation, or treaty described in subsection (a) "is equivalent to the filing of a financing statement."

The quoted phrase appeared in former Section 9-302(3). Its meaning was unclear, and many questions arose concerning the extent to which and manner in which Article 9 rules referring to "filing" were applicable to perfection by compliance with a certificate-of-title statute. This Article takes a variety of approaches for applying Article 9's filing rules to compliance with other statutes and treaties. First, as discussed above in Comment 5, it leaves the determination of some rules, such as the rule establishing time of perfection (Section 9-516(a)), to the other statutes themselves. Second, this Article explicitly applies some Article 9 filing rules to perfection under other statutes or treaties. See, e.g., Section 9-505. Third, this Article makes other Article 9 rules applicable to security interests perfected by compliance with another statute through the "equivalent to . . . filing" provision in the first sentence of Section 9-311(b). The third approach is reflected for the most part in occasional Comments explaining how particular rules apply when perfection is accomplished under Section 9-311(b). See, e.g., Section 9-310, Comment 4; Section 9-315, Comment 6; Section 9-317, Comment 8. The absence of a Comment indicating that a particular filing provision applies to perfection pursuant to Section 9-311(b) does not mean the provision is inapplicable.

7. **Perfection by Possession of Goods Covered by Certificate-of-Title Statute.** A secured party who holds a security interest perfected under the law of State A in goods that subsequently are covered by a State B certificate of title may face a predicament. Ordinarily, the secured party will have four months under State B's Section 9-316(c) and (d) in which to (re-)perfect as against a purchaser of the goods by having its security interest noted on a State B certificate. This procedure is likely to require the cooperation of the debtor and any competing secured party whose security interest has been noted on the certificate. Comment 4(e) to former Section 9-103 observed that "that cooperation is not likely to be forthcoming from an owner who wrongfully procured the issuance of a new certificate not showing the out-of-state security interest, or from a local secured party finding himself in a priority contest with the out-of-state secured party." According to that Comment, "[t]he only solution for the out-of-state secured party under present certificate of title statutes seems to be to reperfect by possession, i.e., by repossessing the goods." But the "solution" may not have worked: Former Section 9-302(4) provided that a security interest in property subject to a certificate-of-title statute "can be perfected only by compliance therewith."

Sections 9-316(d) and (e), 9-311(c), and 9-313(b) of this Article resolve the conflict by providing that a security interest that remains perfected solely by virtue of Section 9-316(e) can be (re)perfected by the secured party's taking possession of the collateral. These sections contemplate only that taking possession of goods covered by a certificate of title will work as a method of perfection. None of these sections creates a right to take possession. Section 9-609 and the agreement of the parties define the secured party's right to take possession.

4-9-312. Perfection of security interests in chattel paper, deposit accounts, documents, goods covered by documents, instruments, investment property, letter-of-credit rights, and money - perfection by permissive filing - temporary perfection without filing or transfer of possession. (a) A security interest in chattel paper, negotiable documents, instruments, or investment property may be perfected by filing.

(b) Except as otherwise provided in section 4-9-315 (c) and (d) for proceeds:

(1) A security interest in a deposit account may be perfected only by control under section 4-9-314; and

(2) Except as otherwise provided in section 4-9-308 (d), a security interest in a letter-of-credit right may be perfected only by control under section 4-9-314; and

(3) A security interest in money may be perfected only by the secured party's taking possession under section 4-9-313.

(c) While goods are in the possession of a bailee that has issued a negotiable document covering the goods:

(1) A security interest in the goods may be perfected by perfecting a security interest in the document; and

(2) A security interest perfected in the document has priority over any security interest that becomes perfected in the goods by another method during that time.

(d) While goods are in the possession of a bailee that has issued a nonnegotiable document covering the goods, a security interest in the goods may be perfected by:

(1) Issuance of a document in the name of the secured party;

(2) The bailee's receipt of notification of the secured party's interest; or

(3) Filing as to the goods.

(e) A security interest in certificated securities, negotiable documents, or instruments is perfected without filing or the taking of possession or control for a period of twenty days from the time it attaches to the extent that it arises for new value given under an authenticated security agreement.

(f) A perfected security interest in a negotiable document or goods in possession of a bailee, other than one that has issued a negotiable document for the goods, remains perfected for twenty days without filing if the secured party makes available to the debtor the goods or documents representing the goods for the purpose of:

(1) Ultimate sale or exchange; or

(2) Loading, unloading, storing, shipping, transshipping, manufacturing, processing, or otherwise dealing with them in a manner preliminary to their sale or exchange.

(g) A perfected security interest in a certificated security or instrument remains perfected for twenty days without filing if the secured party delivers the security certificate or instrument to the debtor for the purpose of:

(1) Ultimate sale or exchange; or

(2) Presentation, collection, enforcement, renewal, or registration of transfer.

(h) After the twenty-day period specified in subsection (e), (f), or (g) of this section expires, perfection depends upon compliance with this article.

Source: L. 2001: Entire article R&RE, p. 1349, § 1, effective July 1. **L. 2006:** (e) amended, p. 501, § 39, effective September 1.

Editor's note: The provisions of this section are similar to former §§ 4-9-115 (4) and 4-9-304 as they existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-304, with additions and some changes.

2. **Instruments.** Under subsection (a), a security interest in instruments may be perfected by filing. This rule represents an important change from former Article 9, under which the secured party's taking possession of an instrument was the only method of achieving long-term perfection. The rule is likely to be particularly useful in transactions involving a large number of notes that a debtor uses as collateral but continues to collect from the makers. A security interest perfected by filing is subject to defeat by certain subsequent purchasers (including secured parties). Under Section 9-330(d), purchasers for value who take possession of an instrument without knowledge that the purchase violates the rights of the secured party generally would achieve priority over a security interest in the instrument perfected by filing. In addition, Section 9-331 provides that filing a financing statement does not constitute notice that would preclude a subsequent purchaser from becoming a holder in due course and taking free of all claims under Section 3-306.

3. **Chattel Paper; Negotiable Documents.** Subsection (a) further provides that filing is available as a method of perfection for security

interests in chattel paper and negotiable documents. Tangible chattel paper is sometimes delivered to the assignee, and sometimes left in the hands of the assignor for collection. Subsection (a) allows the assignee to perfect its security interest by filing in the latter case. Alternatively, the assignee may perfect by taking possession. See Section 9-313(a). An assignee of electronic chattel paper may perfect by taking control. See Sections 9-314(a), 9-105. The security interest of an assignee who takes possession or control may qualify for priority over a competing security interest perfected by filing. See Section 9-330.

Negotiable documents may be, and usually are, delivered to the secured party. The secured party's taking possession will suffice as a perfection step. See Section 9-313(a). However, as is the case with chattel paper, a security interest in a negotiable document may be perfected by filing.

4. **Investment Property.** A security interest in investment property, including certificated securities, uncertificated securities, security entitlements, and securities accounts, may be perfected by filing. However, security interests created by brokers, securities intermediaries, or commodity intermediaries are automatically perfected; filing is of no effect. See Section 9-309(10), (11). A security interest in all kinds of investment property also may be perfected by control, see Sections 9-314, 9-106, and a security interest in a certificated security also may be perfected by the secured party's taking delivery under Section 8-301. See Section 9-313(a). A security interest perfected only by filing is subordinate to a conflicting security interest perfected by control or delivery. See Section 9-328(1), (5). Thus, although filing is a permissible method of perfection, a secured party who perfects by filing takes the risk that the debtor has granted or will grant a security interest in the same collateral to another party who obtains control. Also, perfection by filing would not give the secured party protection against other types of adverse claims, since the Article 8 adverse claim cut-off rules require control. See Section 8-510.

5. **Deposit Accounts.** Under new subsection (b)(1), the only method of perfecting a security interest in a deposit account as original collateral is by control. Filing is ineffective, except as provided in Section 9-315 with respect to proceeds. As explained in Section 9-104, "control" can arise as a result of an agreement among the secured party, debtor, and bank, whereby the bank agrees to comply with instructions of the secured party with respect to disposition of the funds on deposit, even though the debtor retains the right to direct disposition of the funds. Thus, subsection (b)(1) takes an intermediate position between certain non-UCC law, which conditions the effectiveness of a security interest on the secured party's enjoyment of such dominion and control over the deposit account that the debtor is unable to dispose of the funds, and the approach this Article takes to securities accounts, under which a secured party who is unable to reach the collateral without resort to judicial process may perfect by filing. By conditioning perfection on "control," rather than requiring the secured party to enjoy absolute dominion to the exclusion of the debtor, subsection (b)(1) permits perfection in a wide variety of transactions, including those in which the secured party actually relies on the deposit account in extending credit and maintains some meaningful dominion over it, but does not wish to deprive the debtor of access to the funds altogether.

6. **Letter-of-Credit Rights.** Letter-of-credit rights commonly are "supporting obligations," as defined in Section 9-102. Perfection as to the related account, chattel paper, document, general intangible, instrument, or investment property will perfect as to the letter-of-credit rights. See Section 9-308(d). Subsection (b)(2) provides that, in other cases, a security interest in a letter-of-credit right may be perfected only by control. "Control," for these purposes, is explained in Section 9-107.

7. **Goods Covered by Document of Title.** Subsection (c) applies to goods in the possession of a bailee who has issued a negotiable document covering the goods. Subsection (d) applies to goods in the possession of a bailee who has issued a nonnegotiable document of title, including a document of title that is "non-negotiable" under Section 7-104. Section 9-313 governs perfection of a security interest in goods in the possession of a bailee who has not issued a document of title.

Subsection (c) clarifies the perfection and priority rules in former Section 9-304(2). Consistently with the provisions of Article 7, subsection (c) takes the position that, as long as a negotiable document covering goods is outstanding, title to the goods is, so to say, locked up in the document. Accordingly, a security interest in goods covered by a negotiable document may be perfected by perfecting a security interest in the document. The security interest also may be perfected by another method, e.g., by filing. The priority rule in subsection (c) governs only priority between (i) a security interest in goods which is perfected by perfecting in the document and (ii) a security interest in the goods which becomes perfected by another method while the goods are covered by the document.

Example 1: While wheat is in a grain elevator and covered by a negotiable warehouse receipt, Debtor creates a security interest in the wheat in favor of SP-1 and SP-2. SP-1 perfects by filing a financing statement covering "wheat." Thereafter, SP-2 perfects by filing a financing statement describing the warehouse

receipt. Subsection (c)(1) provides that SP-2's security interest is perfected. Subsection (c)(2) provides that SP-2's security interest is senior to SP-1's.

Example 2: The facts are as in Example 1, but SP-1's security interest attached and was perfected before the goods were delivered to the grain elevator. Subsection (c)(2) does not apply, because SP-1's security interest did not become perfected during the time that the wheat was in the possession of a bailee. Rather, the first-to-file-or-perfect priority rule applies. See Section 9-322.

A secured party may become "a holder to whom a negotiable document of title has been duly negotiated" under Section 7-501. If so, the secured party acquires the rights specified by Article 7. Article 9 does not limit those rights, which may include the right to priority over an earlier-perfected security interest. See Section 9-331(a).

Subsection (d) takes a different approach to the problem of goods covered by a nonnegotiable document. Here, title to the goods is not looked on as being locked up in the document, and the secured party may perfect its security interest directly in the goods by filing as to them. The subsection provides two other methods of perfection: issuance of the document in the secured party's name (as consignee of a straight bill of lading or the person to whom delivery would be made under a non-negotiable warehouse receipt) and receipt of notification of the secured party's interest by the bailee. Perfection under subsection (d) occurs when the bailee receives notification of the secured party's interest in the goods, regardless of who sends the notification. Receipt of notification is effective to perfect, regardless of whether the bailee responds. Unlike former Section 9-304(3), from which it derives, subsection (d) does not apply to goods in the possession of a bailee who has not issued a document of title. Section 9-313(c) covers that case and provides that perfection by possession as to goods not covered by a document requires the bailee's acknowledgment.

8. **Temporary Perfection Without Having First Otherwise Perfected.** Subsection (e) follows former Section 9-304(4) in giving perfected status to security interests in certificated securities, instruments, and negotiable documents for a short period (reduced from 21 to 20 days, which is the time period generally applicable in this Article), although there has been no filing and the collateral is in the debtor's possession. The 20-day temporary perfection runs from the date of attachment. There is no limitation on the purpose for which the debtor is in possession, but the secured party must have given "new value" (defined in Section 9-102) under an authenticated security agreement.

9. **Maintaining Perfection After Surrendering Possession.** There are a variety of legitimate reasons many of them are described in subsections (f) and (g) why certain types of collateral must be released temporarily to a debtor. No useful purpose would be served by cluttering the files with records of such exceedingly short term transactions.

Subsection (f) affords the possibility of 20-day perfection in negotiable documents and goods in the possession of a bailee but not covered by a negotiable document. Subsection (g) provides for 20-day perfection in certificated securities and instruments. These subsections derive from former Section 9-305(5). However, the period of temporary perfection has been reduced from 21 to 20 days, which is the time period generally applicable in this Article, and "enforcement" has been added in subsection (g) as one of the special and limited purposes for which a secured party can release an instrument or certificated security to the debtor and still remain perfected. The period of temporary perfection runs from the date a secured party who already has a perfected security interest turns over the collateral to the debtor. There is no new value requirement, but the turnover must be for one or more of the purposes stated in subsection (f) or (g). The 20-day period may be extended by perfecting as to the collateral by another method before the period expires. However, if the security interest is not perfected by another method until after the 20-day period expires, there will be a gap during which the security interest is unperfected.

Temporary perfection extends only to the negotiable document or goods under subsection (f) and only to the certificated security or instrument under subsection (g). It does not extend to proceeds. If the collateral is sold, the security interest will continue in the proceeds for the period specified in Section 9-315.

Subsections (f) and (g) deal only with perfection. Other sections of this Article govern the priority of a security interest in goods after surrender of the document covering them. In the case of a purchase-money security interest in inventory, priority may be conditioned upon giving notification to a prior inventory financer. See Section 9-324.

ANNOTATION

Law reviews. For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

Annotator's note. Since § 4-9-312 is similar to § 4-9-304 as it existed prior to the 2001 repeal and reenactment of this article, a relevant

case construing that provision has been included in the annotations to this section.

Temporarily perfected security interest not rendered permanently perfected if debtor files for bankruptcy while security interest was temporarily perfected. Expeditors Int'l of Wash., Inc. v. Liquidating Trust, 313 B.R. 473 (D. Colo. 2004).

Applied in Midland Bean Co. v. Farmers State Bank, 37 Colo. App. 452, 552 P.2d 317 (1976).

4-9-313. When possession by or delivery to secured party perfects security interest without filing. (a) Except as otherwise provided in subsection (b) of this section, a secured party may perfect a security interest in tangible negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral. A secured party may perfect a security interest in certificated securities by taking delivery of the certificated securities under section 4-8-301.

(b) With respect to goods covered by a certificate of title issued by this state, a secured party may perfect a security interest in the goods by taking possession of the goods only in the circumstances described in section 4-9-316 (d).

(c) With respect to collateral other than certificated securities and goods covered by a document, a secured party takes possession of collateral in the possession of a person other than the debtor, the secured party, or a lessee of the collateral from the debtor in the ordinary course of the debtor's business, when:

(1) The person in possession authenticates a record acknowledging that it holds possession of the collateral for the secured party's benefit; or

(2) The person takes possession of the collateral after having authenticated a record acknowledging that it will hold possession of collateral for the secured party's benefit.

(d) If perfection of a security interest depends upon possession of the collateral by a secured party, perfection occurs no earlier than the time the secured party takes possession and continues only while the secured party retains possession.

(e) A security interest in a certificated security in registered form is perfected by delivery when delivery of the certificated security occurs under section 4-8-301 and remains perfected by delivery until the debtor obtains possession of the security certificate.

(f) A person in possession of collateral is not required to acknowledge that it holds possession for a secured party's benefit.

(g) If a person acknowledges that it holds possession for the secured party's benefit:

(1) The acknowledgment is effective under subsection (c) of this section or section 4-8-301 (a), even if the acknowledgment violates the rights of a debtor; and

(2) Unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the secured party and is not required to confirm the acknowledgment to another person.

(h) A secured party having possession of collateral does not relinquish possession by delivering the collateral to a person other than the debtor or a lessee of the collateral from the debtor in the ordinary course of the debtor's business if the person was instructed before the delivery or is instructed contemporaneously with the delivery:

(1) To hold possession of the collateral for the secured party's benefit; or

(2) To redeliver the collateral to the secured party.

(i) A secured party does not relinquish possession, even if a delivery under subsection (h) of this section violates the rights of a debtor. A person to which collateral is delivered under subsection (h) of this section does not owe any duty to the secured party and is not required to confirm the delivery to another person unless the person otherwise agrees or law other than this article otherwise provides.

(j) References in subsections (g) or (i) of this section regarding violation of the rights of a debtor shall not be construed as limiting the debtor's rights.

Source: L. 2001: Entire article R&RE, p. 1351, § 1, effective July 1. **L. 2006:** (a) amended, p. 502, § 40, effective September 1.

Editor's note: (1) The provisions of this section are similar to former §§ 4-9-115 (4)(b) and 4-9-305 as they existed prior to 2001.

(2) **Colorado legislative change:** Colorado added subsection (j).

OFFICIAL COMMENT

1. **Source.** Former Sections 9-305, 9-115(6).

2. **Perfection by Possession.** As under the common law of pledge, no filing is required by this Article to perfect a security interest if the secured party takes possession of the collateral. See Section 9-310(b)(6).

This section permits a security interest to be perfected by the taking of possession only when the collateral is goods, instruments, negotiable documents, money, or tangible chattel paper. Accounts, commercial tort claims, deposit accounts, investment property, letter-of-credit rights, letters of credit, and oil, gas, or other minerals before extraction are excluded. (But see Comment 6, below, regarding certificated securities.) A security interest in accounts and payment intangibles property not ordinarily represented by any writing whose delivery operates to transfer the right to payment may under this Article be perfected only by filing. This rule would not be affected by the fact that a security agreement or other record described the assignment of such collateral as a "pledge." Section 9-309(2) exempts from filing certain assignments of accounts or payment intangibles which are out of the ordinary course of financing. These exempted assignments are perfected when they attach. Similarly, under Section 9-309(3), sales of payment intangibles are automatically perfected.

3. **"Possession."** This section does not define "possession." It adopts the general concept as it developed under former Article 9. As under former Article 9, in determining whether a particular person has possession, the principles of agency apply. For example, if the collateral is in possession of an agent of the secured party for the purposes of possessing on behalf of the secured party, and if the agent is not also an agent of the debtor, the secured party has taken actual possession, and subsection (c) does not apply. Sometimes a person holds collateral both as an agent of the secured party and as an agent of the debtor. The fact of dual agency is not of itself inconsistent with the secured party's having taken possession (and thereby having rendered subsection (c) inapplicable). The debtor cannot qualify as an agent for the secured party for purposes of the secured party's taking possession. And, under appropriate circumstances, a court may determine that a person in possession is so closely connected to or controlled by the debtor that the debtor has retained effective possession, even though the person may have agreed to take possession on behalf of the secured party. If so, the person's taking possession would not constitute the secured party's taking possession and would not be sufficient for perfection. See also Section 9-205(b). In a typical escrow arrangement, where the escrowee has possession of collateral as agent for both the secured party and the debtor, the debtor's relationship to the escrowee is not such as to constitute retention of possession by the debtor.

4. **Goods in Possession of Third Party: Perfection.** Former Section 9-305 permitted perfection of a security interest by notification to a bailee in possession of collateral. This Article distinguishes between goods in the possession of a bailee who has issued a document of title covering the goods and goods in the possession of a third party who has not issued a document. Section 9-312(c) or (d) applies to the former, depending on whether the document is negotiable. Section 9-313(c) applies to the latter. It provides a method of perfection by possession when the collateral is possessed by a third person who is not the secured party's agent.

Notification of a third person does not suffice to perfect under Section 9-313(c). Rather, perfection does not occur unless the third person authenticates an acknowledgment that it holds possession of the collateral for the secured party's benefit. Compare Section 9-312(d), under which receipt of notification of the security party's interest by a bailee holding goods covered by a nonnegotiable document is sufficient to perfect, even if the bailee does not acknowledge receipt of the notification. A third person may acknowledge that it will hold for the secured party's benefit goods to be received in the future. Under these circumstances, perfection by possession occurs when the third person obtains possession of the goods.

Under subsection (c), acknowledgment of notification by a "lessee . . . in . . . ordinary course of . . . business" (defined in Section 2A-103) does not suffice for possession. The section thus rejects the reasoning of *In re Atlantic Systems, Inc.,* 135 B.R. 463 (Bankr. S.D.N.Y. 1992) (holding that notification to debtor-lessor's lessee sufficed to perfect security interest in leased goods). See Steven O. Weise, *Perfection by Possession: The Need for an Objective Test,* 29 Idaho Law Rev. 705 (1992-93) (arguing that lessee's possession in ordinary course of debtor-lessor's business does not provide adequate public notice of possible security interest in leased goods). Inclusion of a per se rule concerning lessees is not meant to preclude a court, under appropriate circumstances, from determining that a third person is so closely connected to or controlled by the debtor that the debtor has retained effective possession. If so, the third person's acknowledgment would not be sufficient for perfection.

In some cases, it may be uncertain whether a person who has possession of collateral is an agent of the secured party or a non-agent bailee. Under those circumstances, prudence might suggest that the secured party obtain the person's acknowledgment to avoid litigation and

ensure perfection by possession regardless of how the relationship between the secured party and the person is characterized.

5. **No Relation Back.** Former Section 9-305 provided that a security interest is perfected by possession from the time possession is taken "without a relation back." As the Comment to former Section 9-305 observed, the relation-back theory, under which the taking of possession was deemed to relate back to the date of the original security agreement, has had little vitality since the 1938 revision of the Federal Bankruptcy Act. The theory is inconsistent with former Article 9 and with this Article. See Section 9-313(d). Accordingly, this Article deletes the quoted phrase as unnecessary. Where a pledge transaction is contemplated, perfection dates only from the time possession is taken, although a security interest may attach, unperfected. The only exceptions to this rule are the short, 20-day periods of perfection provided in Section 9-312(e), (f), and (g), during which a debtor may have possession of specified collateral in which there is a perfected security interest.

6. **Certificated Securities.** The second sentence of subsection (a) reflects the traditional rule for perfection of a security interest in certificated securities. Compare Section 9-115(6) (1994 Official Text); Sections 8-321, 8-313(1)(a) (1978 Official Text); Section 9-305 (1972 Official Text). It has been modified to refer to "delivery" under Section 8-301. Corresponding changes appear in Section 9-203(b).

Subsection (e), which is new, applies to a secured party in possession of security certificates or another person who has taken delivery of security certificates and holds them for the secured party's benefit under Section 8-301. See Comment 8.

Under subsection (e), a possessory security interest in a certificated security remains perfected until the debtor obtains possession of the security certificate. This rule is analogous to that of Section 9-314(c), which deals with perfection of security interests in investment property by control. See Section 9-314, Comment 3.

7. **Goods Covered by Certificate of Title.** Subsection (b) is necessary to effect changes to the choice-of-law rules governing goods covered by a certificate of title. These changes are described in the Comments to Section 9-311. Subsection (b), like subsection (a), does not create a right to take possession. Rather, it indicates the circumstances under which the secured party's taking possession of goods covered by a certificate of title is effective to perfect a security interest in the goods: the goods become covered by a certificate of title issued by this State at a time when the security interest is perfected by any method under the law of another jurisdiction.

8. **Goods in Possession of Third Party: No Duty to Acknowledge; Consequences of Acknowledgment.** Subsections (f) and (g) are new and address matters as to which former Article 9 was silent. They derive in part from Section 8-106(g). Subsection (f) provides that a person in possession of collateral is not required to acknowledge that it holds for a secured party. Subsection (g)(1) provides that an acknowledgment is effective even if wrongful as to the debtor. Subsection (g)(2) makes clear that an acknowledgment does not give rise to any duties or responsibilities under this Article. Arrangements involving the possession of goods are hardly standardized. They include bailments for services to be performed on the goods (such as repair or processing), for use (leases), as security (pledges), for carriage, and for storage. This Article leaves to the agreement of the parties and to any other applicable law the imposition of duties and responsibilities upon a person who acknowledges under subsection (c). For example, by acknowledging, a third party does not become obliged to act on the secured party's direction or to remain in possession of the collateral unless it agrees to do so or other law so provides.

9. **Delivery to Third Party by Secured Party.** New subsections (h) and (i) address the practice of mortgage warehouse lenders. These lenders typically send mortgage notes to prospective purchasers under cover of letters advising the prospective purchasers that the lenders hold security interests in the notes. These lenders relied on notification to maintain perfection under former 9-305. Requiring them to obtain authenticated acknowledgments from each prospective purchaser under subsection (c) could be unduly burdensome and disruptive of established practices. Under subsection (h), when a secured party in possession itself delivers the collateral to a third party, instructions to the third party would be sufficient to maintain perfection by possession; an acknowledgment would not be necessary. Under subsection (i), the secured party does not relinquish possession by making a delivery under subsection (h), even if the delivery violates the rights of the debtor. That subsection also makes clear that a person to whom collateral is delivered under subsection (h) does not owe any duty to the secured party and is not required to confirm the delivery to another person unless the person otherwise agrees or law other than this Article provides otherwise.

ANNOTATION

Law reviews. For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

Annotator's note. Since § 4-9-313 is similar to § 4-9-305 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Perfected security interest in negotiable instruments. By virtue of a pledge agreement and seller's endorsement and delivery of the buyer's note and the deed of trust, the bank acquires an initial interest which is a perfected security interest in the instruments, such being personal property. Swofford v. Colo. Nat'l Bank, 628 P.2d 184 (Colo. App. 1981).

Bank was not a constructive bailee for a third party claiming rights to money deposited by defendants, therefore no security interest was perfected under this section, even though bank was given notice of third party's claims. In re Carpenter and McAleer Assoc., 815 F. Supp. 384 (D. Colo. 1993).

A security interest in equipment acquisition agreements could not have been perfected by possession because neither party possessed all of the multipally-executed originals of the agreements. A security interest could only have been perfected through proper filing of a financing statement with the secretary of state under § 4-9-304 (1). Denver Tec Bank v. F.D.I.C., 843 P.2d 129 (Colo. App. 1992).

Temporarily perfected security interest not rendered permanently perfected if debtor files for bankruptcy while security interest was temporarily perfected. Expeditors Int'l of Wash., Inc. v. Liquidating Trust, 313 B.R. 473 (D. Colo. 2004).

4-9-314. Perfection by control. (a) A security interest in investment property, deposit accounts, letter-of-credit rights, electronic chattel paper, or electronic documents may be perfected by control of the collateral under section 4-7-106, 4-9-104, 4-9-105, 4-9-106, or 4-9-107.

(b) A security interest in deposit accounts, electronic chattel paper, letter-of-credit rights, or electronic documents is perfected by control under section 4-7-106, 4-9-104, 4-9-105, or 4-9-107 when the secured party obtains control and remains perfected by control only while the secured party retains control.

(c) A security interest in investment property is perfected by control under section 4-9-106 from the time the secured party obtains control and remains perfected by control until:

(1) The secured party does not have control; and

(2) One of the following occurs:

(A) If the collateral is a certificated security, the debtor has or acquires possession of the security certificate;

(B) If the collateral is an uncertificated security, the issuer has registered or registers the debtor as the registered owner; or

(C) If the collateral is a security entitlement, the debtor is or becomes the entitlement holder.

Source: L. 2001: Entire article R&RE, p. 1352, § 1, effective July 1. **L. 2006:** (a) and (b) amended, p. 502, § 41, effective September 1.

Editor's note: This section is similar to former § 4-9-115 (4) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Substantially new; derived in part from former Section 9-115(4).

2. **Control.** This section provides for perfection by control with respect to investment property, deposit accounts, letter-of-credit rights, and electronic chattel paper. For explanations of how a secured party takes control of these types of collateral, see Sections 9-104 through 9-107. Subsection (b) explains when a security interest is perfected by control and how long a security interest remains perfected by control. Like Section 9-313(d) and for the same reasons, subsection (b) makes no reference to the doctrine of "relation back." See Section 9-313, Comment 5.

3. **Investment Property.** Subsection (c) provides a special rule for investment property. Once a secured party has control, its security interest remains perfected by control until the secured party ceases to have control and the

debtor receives possession of collateral that is a certificated security, becomes the registered owner of collateral that is an uncertificated security, or becomes the entitlement holder of collateral that is a security entitlement. The result is particularly important in the "repledge" context. See Section 9-207, Comment 5.

In a transaction in which a secured party who has control grants a security interest in investment property or sells outright the investment property, by virtue of the debtor's consent or applicable legal rules, a purchaser from the secured party typically will cut off the debtor's rights in the investment property or be immune from the debtor's claims. See Section 9-207, Comments 5 and 6. If the investment property is a security, the debtor normally would retain no interest in the security following the purchase from the secured party, and a claim of the debtor against the secured party for redemption (Section 9-623) or otherwise with respect to the security would be a purely personal claim. If the investment property transferred by the secured party is a financial asset in which the debtor had a security entitlement credited to a securities account maintained with the secured party as a securities intermediary, the debtor's claim against the secured party could arise as a part of its securities account notwithstanding its personal nature. (This claim would be analogous to a "credit balance" in the securities account, which is a component of the securities account even though it is a personal claim against the intermediary.) In the case in which the debtor may retain an interest in investment property notwithstanding a repledge or sale by the secured party, subsection (c) makes clear that the security interest will remain perfected by control.

4-9-315. Secured party's rights on disposition of collateral and in proceeds. (a) Except as otherwise provided in this article and in section 4-2-403 (2):

(1) A security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien; and

(2) A security interest attaches to any identifiable proceeds of collateral.

(b) Proceeds that are commingled with other property are identifiable proceeds:

(1) If the proceeds are goods, to the extent provided by section 4-9-336; and

(2) If the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved.

(c) A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.

(d) A perfected security interest in proceeds becomes unperfected on the twenty-first day after the security interest attaches to the proceeds unless:

(1) The following conditions are satisfied:

(A) A filed financing statement covers the original collateral;

(B) The proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and

(C) The proceeds are not acquired with cash proceeds;

(2) The proceeds are identifiable cash proceeds; or

(3) The security interest in the proceeds is perfected other than under subsection (c) of this section when the security interest attaches to the proceeds or within twenty days thereafter.

(e) If a filed financing statement covers the original collateral, a security interest in proceeds which remains perfected under paragraph (1) of subsection (d) of this section becomes unperfected at the later of:

(1) When the effectiveness of the filed financing statement lapses under section 4-9-515 or is terminated under section 4-9-513; or

(2) The twenty-first day after the security interest attaches to the proceeds.

Source: L. 2001: Entire article R&RE, p. 1353, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-306 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-306.

2. **Continuation of Security Interest or Agricultural Lien Following Disposition of Collateral.** Subsection (a)(1), which derives from former Section 9-306(2), contains the general rule that a security interest survives disposition of the collateral. In these cases, the secured party may repossess the collateral from the transferee or, in an appropriate case, maintain an action for conversion. The secured party may claim both any proceeds and the original collateral but, of course, may have only one satisfaction.

In many cases, a purchaser or other transferee of collateral will take free of a security interest, and the secured party's only right will be to proceeds. For example, the general rule does not apply, and a security interest does not continue in collateral, if the secured party authorized the disposition, in the agreement that contains the security agreement or otherwise. Subsection (a)(1) adopts the view of PEB Commentary No. 3 and makes explicit that the authorized disposition to which it refers is an authorized disposition "free of" the security interest or agricultural lien. The secured party's right to proceeds under this section or under the express terms of an agreement does not in itself constitute an authorization of disposition. The change in language from former Section 9-306(2) is not intended to address the frequently litigated situation in which the effectiveness of the secured party's consent to a disposition is conditioned upon the secured party's receipt of the proceeds. In that situation, subsection (a) leaves the determination of authorization to the courts, as under former Article 9.

This Article contains several provisions under which a transferee takes free of a security interest or agricultural lien. For example, Section 9-317 states when transferees take free of unperfected security interests; Sections 9-320 and 9-321 on goods, 9-321 on general intangibles, 9-330 on chattel paper and instruments, and 9-331 on negotiable instruments, negotiable documents, and securities state when purchasers of such collateral take free of a security interest, even though perfected and even though the disposition was not authorized. Section 9-332 enables most transferees (including non-purchasers) of funds from a deposit account and most transferees of money to take free of a perfected security interest in the deposit account or money.

Likewise, the general rule that a security interest survives disposition does not apply if the secured party entrusts goods collateral to a merchant who deals in goods of that kind and the merchant sells the collateral to a buyer in ordinary course of business. Section 2-403(2) gives the merchant the power to transfer all the secured party's rights to the buyer, even if the sale is wrongful as against the secured party. Thus, under subsection (a)(1), an entrusting secured party runs the same risk as any other entruster.

3. **Secured Party's Right to Identifiable Proceeds.** Under subsection (a)(2), which derives from former Section 9-306(2), a security interest attaches to any identifiable "proceeds," as defined in Section 9-102. See also Section 9-203(f). Subsection (b) is new. It indicates when proceeds commingled with other property are identifiable proceeds and permits the use of whatever methods of tracing other law permits with respect to the type of property involved. Among the "equitable principles" whose use other law may permit is the "lowest intermediate balance rule." See Restatement (2d), Trusts § 202.

4. **Automatic Perfection in Proceeds: General Rule.** Under subsection (c), a security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected. This Article extends the period of automatic perfection in proceeds from 10 days to 20 days. Generally, a security interest in proceeds becomes unperfected on the 21st day after the security interest attaches to the proceeds. See subsection (d). The loss of perfected status under subsection (d) is prospective only. Compare, e.g., Section 9-515(c) (deeming security interest unperfected retroactively).

5. **Automatic Perfection in Proceeds: Proceeds Acquired with Cash Proceeds.** Subsection (d)(1) derives from former Section 9-306(3)(a). It carries forward the basic rule that a security interest in proceeds remains perfected beyond the period of automatic perfection if a filed financing statement covers the original collateral (e.g., inventory) and the proceeds are collateral in which a security interest may be perfected by filing in the office where the financing statement has been filed (e.g., equipment). A different rule applies if the proceeds are acquired with cash proceeds, as is the case if the original collateral (inventory) is sold for cash (cash proceeds) that is used to purchase equipment (proceeds). Under these circumstances, the security interest in the equipment proceeds remains perfected only if the description in the filed financing indicates the type of property constituting the proceeds (e.g., "equipment").

This section reaches the same result but takes a different approach. It recognizes that the treatment of proceeds acquired with cash proceeds under former Section 9-306(3)(a) essentially was superfluous. In the example, had the filing covered "equipment" as well as "inventory," the security interest in the proceeds would have been perfected under the usual rules governing after-acquired equipment (see former Sections 9-302, 9-303); paragraph (3)(a) added only an

exception to the general rule. Subsection (d)(1)(C) of this section takes a more direct approach. It makes the general rule of continued perfection inapplicable to proceeds acquired with cash proceeds, leaving perfection of a security interest in those proceeds to the generally applicable perfection rules under subsection (d)(3).

Example 1: Lender perfects a security interest in Debtor's inventory by filing a financing statement covering "inventory." Debtor sells the inventory and deposits the buyer's check into a deposit account. Debtor draws a check on the deposit account and uses it to pay for equipment. Under the "lowest intermediate balance rule," which is a permitted method of tracing in the relevant jurisdiction, see Comment 3, the funds used to pay for the equipment were identifiable proceeds of the inventory. Because the proceeds (equipment) were acquired with cash proceeds (deposit account), subsection (d)(1) does not extend perfection beyond the 20-day automatic period.

Example 2: Lender perfects a security interest in Debtor's inventory by filing a financing statement covering "all debtor's property." As in Example 1, Debtor sells the inventory, deposits the buyer's check into a deposit account, draws a check on the deposit account, and uses the check to pay for equipment. Under the "lowest intermediate balance rule," which is a permitted method of tracing in the relevant jurisdiction, see Comment 3, the funds used to pay for the equipment were identifiable proceeds of the inventory. Because the proceeds (equipment) were acquired with cash proceeds (deposit account), subsection (d)(1) does not extend perfection beyond the 20-day automatic period. However, because the financing statement is sufficient to perfect a security interest in debtor's equipment, under subsection (d)(3) the security interest in the equipment proceeds remains perfected beyond the 20-day period.

6. **Automatic Perfection in Proceeds: Lapse or Termination of Financing Statement During 20-Day Period; Perfection Under Other Statute or Treaty.** Subsection (e) provides that a security interest in proceeds perfected under subsection (d)(1) ceases to be perfected when the financing statement covering the original collateral lapses or is terminated. If the lapse or termination occurs before the 21st day after the security interest attaches, however, the security interest in the proceeds remains perfected until the 21st day. Section 9-311(b) provides that compliance with the perfection requirements of a statute or treaty described in Section 9-311(a) "is equivalent to the filing of a financing statement." It follows that collateral subject to a security interest perfected by such compliance under Section 9-311(b) is covered by a "filed financing statement" within the meaning of Section 9-315(d) and (e).

7. **Automatic Perfection in Proceeds: Continuation of Perfection in Cash Proceeds.** Former Section 9-306(3)(b) provided that if a filed financing statement covered original collateral, a security interest in identifiable cash proceeds of the collateral remained perfected beyond the ten-day period of automatic perfection. Former Section 9-306(3)(c) contained a similar rule with respect to identifiable cash proceeds of investment property. Subsection (d)(2) extends the benefits of former Sections 9-306(3)(b) and (3)(c) to identifiable cash proceeds of all types of original collateral in which a security interest is perfected by any method. Under subsection (d)(2), if the security interest in the original collateral was perfected, a security interest in identifiable cash proceeds will remain perfected indefinitely, regardless of whether the security interest in the original collateral remains perfected. In many cases, however, a purchaser or other transferee of the cash proceeds will take free of the perfected security interest. See, e.g., Sections 9-330(d) (purchaser of check), 9-331 (holder in due course of check), 9-332 (transferee of money or funds from a deposit account).

8. **Insolvency Proceedings; Returned and Repossessed Goods.** This Article deletes former Section 9-306(4), which dealt with proceeds in insolvency proceedings. Except as otherwise provided by the Bankruptcy Code, the debtor's entering into bankruptcy does not affect a secured party's right to proceeds.

This Article also deletes former Section 9-306(5), which dealt with returned and repossessed goods. Section 9-330, Comments 9 to 11 explain and clarify the application of priority rules to returned and repossessed goods as proceeds of chattel paper.

9. **Proceeds of Collateral Subject to Agricultural Lien.** This Article does not determine whether a lien extends to proceeds of farm products encumbered by an agricultural lien. If, however, the proceeds are themselves farm products on which an "agricultural lien" (defined in Section 9-102) arises under other law, then the agricultural-lien provisions of this Article apply to the agricultural lien on the proceeds in the same way in which they would apply had the farm products not been proceeds.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Commercial Law", see 58 Den. L.J. 279 (1981). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Commercial and Cor-

porate Law", which discusses a recent Tenth Circuit decision dealing with perfection in proceeds in event of insolvency proceedings, see 65 Den. U. L. Rev. 469 (1988). For article, "Setoff and Security Interests In Deposit Accounts", see 17 Colo. Law. 2108 (1988).

Annotator's note. Since § 4-9-315 is similar to § 4-9-306 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

This section and § 4-9-311 must be read together. Section 4-9-311 does not invalidate the prior security interest under subsection (2). Am. Heritage Bank & Trust Co. v. O. & E., Inc., 40 Colo. App. 306, 576 P.2d 566 (1978).

For the inconsistency between § 4-9-203 and this section on subject of proceeds, see Fort Collins Prod. Credit Ass'n v. Carroll Dairy, 37 Colo. App. 536, 553 P.2d 95 (1976) (decided prior to the 1977 amendment of this section and § 4-9-203).

Nothing in the language of subsection (1) requires that the disposition of collateral must be final in order to generate proceeds. In re Clancy & Co. Const., Inc., 214 Bankr. 387 (Bankr. D. Colo. 1997).

Effect of failure to use word "proceeds" in security agreement. Even absent use of the specific word "proceeds" in a security agreement, the lender continues, under the uniform commercial code, to have a secured interest in money received from the sale of personalty covered specifically in the agreement. Fort Collins Prod. Credit Ass'n v. Carroll Dairy, 37 Colo. App. 536, 553 P.2d 95 (1976).

Cattle which eat feed in which there is a security interest do not constitute proceeds of the collateral by application of this section. First Nat'l Bank v. Bostron, 39 Colo. App. 107, 564 P.2d 964 (1977).

There could be no traceable "proceeds" to which a security interest in cattle feed may be said to have attached when the cattle have consumed the feed, and therefore such a security interest could not survive consumption of the feed by the cattle. First Nat'l Bank v. Bostron, 37 Colo. App. 107, 564 P.2d 964 (1977).

Wool incentive payments are "proceeds" of the wool. In re Mahleres, 53 Bankr. 86 (Bankr. D. Colo. 1985).

Satisfaction of judgment constituted only "identifiable proceeds in the hands of the debtor", when the debtor paid to judgment creditor the cash proceeds of sale of equipment in which bank held security interest, and thus bank in enforcing its security interest in identifiable proceeds of sale was not entitled to recover from judgment creditor the amount paid by debtor. First Interstate Bank v. Arizona Agrochemical, 731 P.2d 746 (Colo. App. 1986).

Implied authorization for sale or other disposition of collateral must be determined based upon the circumstances of the parties, the nature of the collateral, the course of dealing of the parties, and the usage of trade. Platte Valley Bank v. B & J Constr., Inc., 44 Colo. App. 21, 606 P.2d 455 (1980); Mid-States Sales Co. v. Mountain Empire Dairymen's Ass'n, 741 P.2d 342 (Colo. App. 1987); Morgan County Feeders, Inc. v. McCormick, 836 P.2d 1051 (Colo. App. 1992).

Existence of implied authorization is a factual determination. Morgan County Feeders, Inc. v. McCormick, 836 P.2d 1051 (Colo. App. 1992).

Bank's interest in collateral is not terminated by failure to participate in garnishment action, and its security interest follows the collateral. El Paso County Bank v. Charles R. Milisen & Co., 622 P.2d 594 (Colo. App. 1980).

Bank lost lien on corn by consenting to sale. Where lending bank, which held a security interest in the corn crop grown by a borrowing farmer, consented to the sale of the crop, the bank lost its lien on the corn. Farmers Nat'l Bank v. Ceres Land Co., 32 Colo. App. 290, 512 P.2d 1174 (1973).

Subsection (4)(d) replaces the common law rules of tracing in the context of insolvency proceedings. In re Intermountain Porta Storage, Inc., 74 Bankr. 1011 (D. Colo. 1987).

Creditor does not waive its security interest in dairy cattle by authorizing the sale of milk, but did waive its security interest to the extent it allowed distribution of the proceeds from the sale to other creditors during the customary course of dealing between the parties. Mid-States Sales v. Mt. Empire Dairymen's, 741 P.2d 342 (Colo. App. 1987).

Livestock broker engaged in conversion when it sold borrowers' cattle, which was subject to a security interest, and remitted proceeds to borrowers. Ignorance of the security interest was no defense. United States v. Winter Livestock Comm'n, 924 F.2d 986 (10th Cir. 1991).

The 10-day automatic perfection period provided by this section is not extended in the event insolvency proceedings are commenced. Following expiration of the 10-day period of automatic perfection, the mortgage financier became a general unsecured creditor of the debtor. In re Reliance Equities, Inc. 966 F.2d 1338 (10th Cir. 1992).

One cannot perfect a security interest in proceeds if the security interest in the original collateral was not perfected. Subsection (3) must be read in context of the entire section and addresses the means to perfect an interest in proceeds beyond the 10-day period, when the previously perfected interest ceases to be perfected under this section. In re Carpenter & McAleer Assocs., 815 F. Supp. 384 (D. Colo. 1993).

Since security interest in original collateral was perfected by possession, even if only for a short period of time, the security interest in the identifiable cash proceeds thereof is perfected indefinitely under this section. Expeditors Int'l of Wash., Inc. v. Liquidating Trust, 313 B.R. 473 (D. Colo. 2004).

Pursuant to § 42-6-120, this section applies to a security interest in a motor vehicle held in inventory, notwithstanding the requirement in § 42-6-109, that the certificate of title is required to transfer an interest in a motor vehicle. Although a bank had a perfected security interest in an auto dealer's inventory, the interest was extinguished upon sale of the vehicle because the bank authorized the sale of the inventory. Under this section, the bank is left with a security interest only in the proceeds of the sale. Therefore, a credit union that financed the purchase of the vehicle from the dealer has a security interest that prevails against the bank, even though the certificate of title was not conveyed to the credit union at the time of sale. Valley Bank & Trust Co. v. Holyoke Cmty. Fed. Credit Union, 121 P.3d 358 (Colo. App. 2005).

Applied in Chambers v. Nation, 178 Colo. 124, 497 P.2d 5 (1972); Western Nat'l Bank v. ABC Drilling Co., 42 Colo. App. 407, 599 P.2d 942 (1979); Layne v. Fort Carson Nat'l Bank, 655 P.2d 856 (Colo. App. 1982).

4-9-316. Continued perfection of security interest following change in governing law. (a) A security interest perfected pursuant to the law of the jurisdiction designated in section 4-9-301 (1) or 4-9-305 (c) remains perfected until the earliest of:

(1) The time perfection would have ceased under the law of that jurisdiction;

(2) The expiration of four months after a change of the debtor's location to another jurisdiction; or

(3) The expiration of one year after a transfer of collateral to a person that thereby becomes a debtor and is located in another jurisdiction.

(b) If a security interest described in subsection (a) of this section becomes perfected under the law of the other jurisdiction before the earliest time or event described in said subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earliest time or event, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

(c) A possessory security interest in collateral, other than goods covered by a certificate of title and as-extracted collateral consisting of goods, remains continuously perfected if:

(1) The collateral is located in one jurisdiction and subject to a security interest perfected under the law of that jurisdiction;

(2) Thereafter the collateral is brought into another jurisdiction; and

(3) Upon entry into the other jurisdiction, the security interest is perfected under the law of the other jurisdiction.

(d) Except as otherwise provided in subsection (e) of this section, a security interest in goods covered by a certificate of title which is perfected by any method under the law of another jurisdiction when the goods become covered by a certificate of title from this state remains perfected until the security interest would have become unperfected under the law of the other jurisdiction had the goods not become so covered.

(e) A security interest described in subsection (d) of this section becomes unperfected as against a purchaser of the goods for value and is deemed never to have been perfected as against a purchaser of the goods for value if the applicable requirements for perfection under section 4-9-311 (b) or 4-9-313 are not satisfied before the earlier of:

(1) The time the security interest would have become unperfected under the law of the other jurisdiction had the goods not become covered by a certificate of title from this state; or

(2) The expiration of four months after the goods had become so covered.

(f) A security interest in deposit accounts, letter-of-credit rights, or investment property which is perfected under the law of the bank's jurisdiction, the issuer's jurisdiction, a nominated person's jurisdiction, the securities intermediary's jurisdiction, or the commodity intermediary's jurisdiction, as applicable, remains perfected until the earlier of:

(1) The time the security interest would have become unperfected under the law of that jurisdiction; or

(2) The expiration of four months after a change of the applicable jurisdiction to another jurisdiction.

(g) If a security interest described in subsection (f) of this section becomes perfected under the law of the other jurisdiction before the earlier of the time or the end of the period described in said subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earlier of that time or the end of that period, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

(h) The following rules apply to collateral to which a security interest attaches within four months after the debtor changes its location to another jurisdiction:

(1) A financing statement filed before the change pursuant to the law of the jurisdiction designated in section 4-9-301 (1) or 4-9-305 (c) is effective to perfect a security interest in the collateral if the financing statement would have been effective to perfect a security interest in the collateral had the debtor not changed its location.

(2) If a security interest perfected by a financing statement that is effective under paragraph (1) of this subsection (h) becomes perfected under the law of the other jurisdiction before the earlier of the time the financing statement would have become ineffective under the law of the jurisdiction designated in section 4-9-301 (1) or 4-9-305 (c) or the expiration of the four-month period, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earlier time or event, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

Editor's note: Subsection (h) is effective July 1, 2013.

(i) If a financing statement naming an original debtor is filed pursuant to the law of the jurisdiction designated in section 4-9-301 (1) or 4-9-305 (c) and the new debtor is located in another jurisdiction, the following rules apply:

(1) The financing statement is effective to perfect a security interest in collateral acquired by the new debtor before, and within four months after, the new debtor becomes bound under section 4-9-203 (d) if the financing statement would have been effective to perfect a security interest in the collateral had the collateral been acquired by the original debtor.

(2) A security interest that is perfected by the financing statement and that becomes perfected under the law of the other jurisdiction before the earlier of the time the financing statement would have become ineffective under the law of the jurisdiction designated in section 4-9-301 (1) or 4-9-305 (c) or the expiration of the four-month period remains perfected thereafter. A security interest that is perfected by the financing statement but that does not become perfected under the law of the other jurisdiction before the earlier time or event becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

Editor's note: Subsection (i) is effective July 1, 2013.

Source: L. 2001: Entire article R&RE, p. 1354, § 1, effective July 1. **L. 2012:** (h) and (i) added, (HB 12-1262), ch. 170, p. 598, § 5, effective July 1, 2013.

Editor's note: (1) This section is similar to former § 4-9-103 as it existed prior to 2001.

(2) "Continued perfection of security interest following" portion of the headnote for this section will be replaced with "Effect of", effective July 1, 2013.

OFFICIAL COMMENT

1. **Source.** Former Section 9-103(1)(d), (2)(b), (3)(e), as modified.

2. **Continued Perfection.** This section deals with continued perfection of security interests that have been perfected under the law of another jurisdiction. The fact that the law of a particular jurisdiction ceases to govern perfection under Sections 9-301 through 9-307 does not necessarily mean that a security interest perfected under that law automatically becomes unperfected. To the contrary: This section generally provides that a security interest perfected under the law of one jurisdiction remains perfected for a fixed period of time (four months or one year, depending on the circumstances), even though the jurisdiction whose law governs per-

fection changes. However, cessation of perfection under the law of the original jurisdiction cuts short the fixed period. The four-month and one-year periods are long enough for a secured party to discover in most cases that the law of a different jurisdiction governs perfection and to reperfect (typically by filing) under the law of that jurisdiction. If a secured party properly reperfects a security interest before it becomes unperfected under subsection (a), then the security interest remains perfected continuously thereafter. See subsection (b).
Note: "This section deals" in the first sentence will be replaced with "Subsections (a) through (g) deal" effective July 1, 2013.

Example 1: Debtor is a general partnership whose chief executive office is in Pennsylvania. Lender perfects a security interest in Debtor's equipment by filing in Pennsylvania on May 15, 2002. On April 1, 2005, without Lender's knowledge, Debtor moves its chief executive office to New Jersey. Lender's security interest remains perfected for four months after the move. See subsection (a)(2).

Example 2: Debtor is a general partnership whose chief executive office is in Pennsylvania. Lender perfects a security interest in Debtor's equipment by filing in Pennsylvania on May 15, 2002. On April 1, 2007, without Lender's knowledge, Debtor moves its chief executive office to New Jersey. Lender's security interest remains perfected only through May 14, 2007, when the effectiveness of the filed financing statement lapses. See subsection (a)(1). Although, under these facts, Lender would have only a short period of time to discover that Debtor had relocated and to reperfect under New Jersey law, Lender could have protected itself by filing a continuation statement in Pennsylvania before Debtor relocated. By doing so, Lender would have prevented lapse and allowed itself the full four months to discover Debtor's new location and refile there or, if Debtor is in default, to perfect by taking possession of the equipment.

Example 3: Under the facts of Example 2, Lender files a financing statement in New Jersey before the effectiveness of the Pennsylvania financing statement lapses. Under subsection (b), Lender's security interest is continuously perfected beyond May 14, 2007, for a period determined by New Jersey's Article 9.

Subsection (a)(3) allows a one-year period in which to reperfect. The longer period is necessary, because, even with the exercise of due diligence, the secured party may be unable to discover that the collateral has been transferred to a person located in another jurisdiction. [In any event, the period is cut short if the financing statement becomes ineffective under the law of the jurisdiction in which it is filed.]
Note: The bracketed language takes effect July 1, 2013.

Example 4: Debtor is a Pennsylvania corporation. Lender perfects a security interest in Debtor's equipment by filing in Pennsylvania. Debtor's shareholders decide to "reincorporate" in Delaware. They form a Delaware corporation (Newcorp) into which they merge Debtor. The merger effectuates a transfer of the collateral from Debtor to Newcorp, which thereby becomes a debtor and is located in another jurisdiction. Under subsection (a)(3), the security interest remains perfected for one year after the merger. If a financing statement is filed in Delaware against Newcorp within the year following the merger, then the security interest remains perfected thereafter for a period determined by Delaware's Article 9.
Note:"On January 1," will be inserted at the begining of the second sentence and "On March 1," will be inserted at the begining of the fourth sentence, effective July 1, 2013.

Note that although Newcorp is a "new debtor" as defined in Section 9-102, the application of subsection (a)(3) is not limited to transferees who are new debtors. Note also that, under Section 9-507, the financing statement naming Debtor remains effective even though Newcorp has become the debtor.

This section addresses security interests that are perfected (i.e., that have attached and as to which any required perfection step has been taken) before the debtor changes its location. As the following example explains, this section does not apply to security interests that have not attached before the location changes.
Note: This version of this paragraph is effective until July 1, 2013.

Subsection (a) addresses security interests that are perfected (i.e., that have attached and as to which any required perfection step has been taken) before the debtor changes its location. Subsection (h) applies to security interests that have not attached before the location changes. See Comment 7.
Note: This version of this paragraph takes effect July 1, 2013.

[Example 5: Debtor is a Pennsylvania corporation. Debtor grants to Lender a security interest in Debtor's existing and after-acquired inventory. Lender perfects by filing in Pennsylvania. Debtor's shareholders decide to "reincorporate" in Delaware. They form a Delaware corporation (Newcorp) into which they merge Debtor. By virtue of the merger, Newcorp becomes bound by Debtor's security agreement. See Section 9-203. After the merger, Newcorp acquires inventory to which Lender's security interest attaches. Because Newcorp is located in Delaware, Delaware law governs perfection of a security interest in Newcorp's inventory. See Sections 9-301, 9-307. Having failed to perfect under Delaware law, Lender holds an unperfected security interest in the inventory acquired by Newcorp after the merger. The same result

follows regardless of the name of the Delaware corporation (i.e., even if the Delaware corporation and Debtor have the same name). A different result would occur if Debtor and Newcorp were incorporated in the same state. See Section 9-508, Comment 4.]

Note: Example 5 will be deleted, effective July 1, 2013.

3. **Retroactive Unperfection.** Subsection (b) sets forth the consequences of the failure to reperfect before perfection ceases under subsection (a): the security interest becomes unperfected prospectively and, as against purchasers for value, including buyers and secured parties, but not as against donees or lien creditors, retroactively. The rule applies to agricultural liens, as well. See also Section 9-515 (taking the same approach with respect to lapse). Although this approach creates the potential for circular priorities, the alternative retroactive unperfection against lien creditors would create substantial and unjustifiable preference risks.

Example 6: Under the facts of Example 4, six months after the merger, Buyer bought from Newcorp some equipment formerly owned by Debtor. At the time of the purchase, Buyer took subject to Lender's perfected security interest, of which Buyer was unaware. See Section 9-315(a)(1). However, subsection (b) provides that if Lender fails to reperfect in Delaware within a year after the merger, its security interest becomes unperfected and is deemed never to have been perfected against Buyer. Having given value and received delivery of the equipment without knowledge of the security interest and before it was perfected, Buyer would take free of the security interest. See Section 9-317(b).

Note: "**Example 6:**" will be replaced by "**Example 5:**" effective July 1, 2013.

Example 7: Under the facts of Example 4, one month before the merger, Debtor created a security interest in certain equipment in favor of Financer, who perfected by filing in Pennsylvania. At that time, Financer's security interest is subordinate to Lender's. See Section 9-322(a)(1). Financer reperfects by filing in Delaware within a year after the merger, but Lender fails to do so. Under subsection (b), Lender's security interest is deemed never to have been perfected against Financer, a purchaser for value. Consequently, under Section 9-322(a)(2), Financer's security interest is now senior.

Note: "**Example 7:**" will be replaced by "**Example 6:**" effective July 1, 2013.

Of course, the expiration of the time period specified in subsection (a) does not of itself prevent the secured party from later reperfecting under the law of the new jurisdiction. If the secured party does so, however, there will be a gap in perfection, and the secured party may lose priority as a result. Thus, in Example 7, if Lender perfects by filing in Delaware more than one year under the merger, it will have a new date of filing and perfection for purposes of Section 9-322(a)(1). Financer's security interest, whose perfection dates back to the filing in Pennsylvania under subsection (b), will remain senior.

Note: "Example 7," in the fourth sentence will be replaced with "Example 6," effective July 1, 2013.

4. **Possessory Security Interests.** Subsection (c) deals with continued perfection of possessory security interests. It applies not only to security interests perfected solely by the secured party's having taken possession of the collateral. It also applies to security interests perfected by a method that includes as an element of perfection the secured party's having taken possession, such as perfection by taking delivery of a certificated security in registered form, see Section 9-313(a), and perfection by obtaining control over a certificated security. See Section 9-314(a).

5. **Goods Covered by Certificate of Title.** Subsections (d) and (e) address continued perfection of a security interest in goods covered by a certificate of title. The following examples explain the operation of those subsections.

Example 8: Debtor's automobile is covered by a certificate of title issued by Illinois. Lender perfects a security interest in the automobile by complying with Illinois' certificate-of-title statute. Thereafter, Debtor applies for a certificate of title in Indiana. Six months thereafter, Creditor acquires a judicial lien on the automobile. Under Section 9-303(b), Illinois law ceases to govern perfection; rather, once Debtor delivers the application and applicable fee to the appropriate Indiana authority, Indiana law governs. Nevertheless, under Indiana's Section 9-316(d), Lender's security interest remains perfected until it would become unperfected under Illinois law had no certificate of title been issued by Indiana. (For example, Illinois' certificate-of-title statute may provide that the surrender of an Illinois certificate of title in connection with the issuance of a certificate of title by another jurisdiction causes a security interest noted thereon to become unperfected.) If Lender's security interest remains perfected, it is senior to Creditor's judicial lien.

Note: "**Example 8:**" will be replaced by "**Example 7:**" effective July 1, 2013.

Example 9: Under the facts in Example 8, five months after Debtor applies for an Indiana certificate of title, Debtor sells the automobile to Buyer. Under subsection (e)(2), because Lender did not reperfect within the four months after the goods became covered by the Indiana certificate of title, Lender's security interest is deemed never to have been perfected against Buyer. Under Section 9-317(b), Buyer is likely to take free of the security interest. Lender could have protected itself by perfecting its security interest

either under Indiana's certificate-of-title statute, see Section 9-311, or, if it had a right to do so under an agreement or Section 9-609, by taking possession of the automobile. See Section 9-313(b).

Note: "**Example 9:**" will be replaced with "**Example 8:**" and the reference to "Example 8," in the first sentence will be replaced with "Example 7," effective July 1, 2013.

The results in Examples 8 and 9 do not depend on the fact that the original perfection was achieved by notation on a certificate of title. Subsection (d) applies regardless of the method by which a security interest is perfected under the law of another jurisdiction when the goods became covered by a certificate of title from this State.

Note: "Examples 8 and 9" will be replaced with "Examples 7 and 8", effective July 1, 2013.

Section 9-337 affords protection to a limited class of persons buying or acquiring a security interest in the goods while a security interest is perfected under the law of another jurisdiction but after this State has issued a clean certificate of title.

6. **Deposit Accounts, Letter-of-Credit Rights, and Investment Property.** Subsections (f) and (g) address changes in the jurisdiction of a bank, issuer of an uncertificated security, issuer of or nominated person under a letter of credit, securities intermediary, and commodity intermediary. The provisions are analogous to those of subsections (a) and (b)

[7. **Security Interests that Attach after Debtor Changes Location.** In contrast to subsections (a) and (b), which address security interests that are perfected (i.e., that have attached and as to which any required perfection step has been taken) before the debtor changes its location, subsection (h) addresses security interests that attach within four months after the debtor changes its location. Under subsection (h), a filed financing statement that would have been effective to perfect a security interest in the collateral if the debtor had not changed its location is effective to perfect a security interest in collateral acquired within four months after the relocation.]

Note: The bracketed language takes effect July 1, 2013.

[**Example 9:** Debtor, an individual whose principal residence is in Pennsylvania, grants to Lender a security interest in Debtor's existing and after-acquired inventory. Lender perfects the security interest by filing a proper financing statement in Pennsylvania on January 2, 2014. On March 31, 2014, Debtor's principal residence is relocated to New Jersey. Upon the relocation, New Jersey law governs perfection of a security interest in Debtor's inventory. See Sections 9-301, 9-307. Under New Jersey's Section 9-316(a), Lender's security interest in Debtor's inventory on hand at the time of the relocation remains perfected for four months thereafter. Had Debtor not relocated, the financing statement filed in Pennsylvania would have been effective to perfect Lender's security interest in inventory acquired by Debtor after March 31, 2014. Accordingly, under subsection (h), the financing statement is effective to perfect Lender's security interest in inventory that Debtor acquires within the four months after Debtor's location changed.]

Note: The bracketed language takes effect July 1, 2013.

[In Example 9, Lender's security interest in the inventory acquired within the four months after Debtor's relocation will be perfected when it attaches. It will remain perfected if, before the expiration of the four-month period, the security interest is perfected under the law of New Jersey. Otherwise, the security interest will become unperfected at the end of the four-month period and will be deemed never to have been perfected as against a purchaser for value. See subsection (h)(2).]

Note: The bracketed language takes effect July 1, 2013.

[8. **Collateral Acquired by New Debtor.** Subsection (i) is similar to subsection (h). Whereas subsection (h) addresses security interests that attach within four months after a debtor changes its location, subsection (i) addresses security interests that attach within four months after a new debtor becomes bound as debtor by a security agreement entered into by another person. Subsection (i) also addresses collateral acquired by the new debtor before it becomes bound.]

Note: The bracketed language takes effect July 1, 2013.

[**Example 10:** Debtor, a Pennsylvania corporation, grants to Lender a security interest in Debtor's existing and after-acquired inventory. Lender perfects the security interest by filing a proper financing statement in Pennsylvania on January 2, 2014. On March 31, 2014, Debtor merges into Survivor, a Delaware corporation. Because Survivor is located in Delaware, Delaware law governs perfection of a security interest in Survivor's inventory. See Sections 9-301, 9-307. Under Delaware's Section 9-316(a), Lender's security interest in the inventory that Survivor acquired from Debtor remains perfected for one year after the transfer. See Comment 2. By virtue of the merger, Survivor becomes bound as debtor by Debtor's security agreement. See Section 9-203(d). As a consequence, Lender's security interest attaches to all of Survivor's inventory under Section 9-203, and Lender's collateral now includes inventory in which Debtor never had an interest. The financing statement filed in Pennsylvania against Debtor is effective under Delaware's Section 9-316(i) to perfect Lender's security interest in inventory that Survivor acquired be-

fore, and within the four months after, becoming bound as debtor by Debtor's security agreement. This is because the financing statement filed in Pennsylvania would have been effective to perfect Lender's security interest in this collateral had Debtor, rather than Survivor, acquired it.]
Note: The bracketed language takes effect July 1, 2013.

[If the financing statement is effective, Lender's security interest in the collateral that Survivor acquired before, and within four months after, Survivor became bound as debtor will be perfected upon attachment. It will remain perfected if, before the expiration of the four-month period, the security interest is perfected under Delaware law. Otherwise, the security interest will become unperfected at the end of the four-month period and will be deemed never to have been perfected as against a purchaser for value.]
Note: The bracketed language takes effect July 1, 2013.

[Section 9-325 contains special rules governing the priority of competing security interests in collateral that is transferred, by merger or otherwise, to a new debtor or other person who becomes a debtor with respect to the collateral. Section 9-326 contains special rules governing the priority of competing security interests in collateral acquired by a new debtor other than by transfer from the original debtor.]
Note: The bracketed language takes effect July 1, 2013.

7. **Agricultural Liens.** This section does not apply to agricultural liens.
Note: "7. **Agricultural Liens.**" will be replaced with "9. **Agricultural Liens.**", effective July 1, 2013.

Example 10: Supplier holds an agricultural lien on corn. The lien arises under an Iowa statute. Supplier perfects by filing a financing statement in Iowa, where the corn is located. See Section 9-302. Debtor stores the corn in Missouri. Assume the Iowa agricultural lien survives or an agricultural lien arises under Missouri law (matters that this Article does not govern). Once the corn is located in Missouri, Missouri becomes the jurisdiction whose law governs perfection. See Section 9-302. Thus, the agricultural lien will not be perfected unless Supplier files a financing statement in Missouri.
Note: "**Example 10:**" will be replaced with "**Example 11:**", effective July 1, 2013.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Annotator's note. Since § 4-9-316 is similar to § 4-9-103 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

The validity of foreign security interests in personal property is governed by this section except to the extent that motor vehicle titles are governed by § 42-6-131, and the usage of the broad term "motor vehicle titles" indicates the legislative intent that whenever the question as to title to a motor vehicle arises with regard to a foreign security interest, the question is to be answered by application of § 42-6-131 and is precluded from the application of the provisions of § 4-9-103(3). Doenges-Glass, Inc. v. General Motors Acceptance Corp., 175 Colo. 518, 488 P.2d 879 (1971).

Code as enacted in New York determined validity and perfection of security interest. Where seller's only office is located in New York, and assignee of seller's accounts receivable is a New York corporation, the requirements of the uniform commercial code as enacted by New York determines the validity and perfection of assignee's security interest in accounts receivable. Barocas v. Bohemia Import Co., 33 Colo. App. 263, 518 P.2d 850 (1974).

The right to collect annual campground membership dues is a right to payment for services rendered, which is an ordinary commercial account receivable. If the security interest is in accounts, the law of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or nonperfection of the security interest. Therefore, since the debtor was located at its place of business in Florida, Florida was the proper jurisdiction in which to file in order to perfect a security interest in the collateral, making the location of the collateral in Colorado irrelevant. Capitran Inc. v. Great Western Bank, 872 P.2d 1370 (Colo. App. 1994).

Farm combine which was type used by custom crop cutting in multi-state operations is mobile equipment within the meaning of § 4-9-103 (3)(a). Golden Plains Credit Union v. Konkel, 759 P.2d 788 (Colo. App. 1988), aff'd in part and rev'd in part, 778 P.2d 660 (Colo. 1989).

The provisions of this section and § 4-9-401 (1) are not mutually exclusive and, if equipment meets the requirements of both statutory provisions, it must be considered to fall into both categories. Golden Plains Credit Union v. Konkel, 759 P.2d 788 (Colo. App. 1988), aff'd in part and rev'd in part, 778 P.2d 660 (Colo. 1989).

4-9-317. Interests that take priority over or take free of security interest or agricultural lien. (a) A security interest or agricultural lien is subordinate to the rights of:

(1) A person entitled to priority under section 4-9-322; and

(2) Except as otherwise provided in subsection (e) of this section, a person that becomes a lien creditor before the security interest or agricultural lien is perfected.

(b) Except as otherwise provided in subsection (e) of this section, a buyer, other than a secured party, of tangible chattel paper, tangible documents, goods, instruments, or a security certificate takes free of a security interest or agricultural lien if the buyer gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

Editor's note: This version of subsection (b) is effective until July 1, 2013.

(b) Except as otherwise provided in subsection (e) of this section, a buyer, other than a secured party, of tangible chattel paper, tangible documents, goods, instruments, or a certificated security takes free of a security interest or agricultural lien if the buyer gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

Editor's note: This version of subsection (b) is effective July 1, 2013.

(c) Except as otherwise provided in subsection (e) of this section, a lessee of goods takes free of a security interest or agricultural lien if the lessee gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

(d) A licensee of a general intangible or a buyer, other than a secured party, of accounts, electronic chattel paper, electronic documents, general intangibles, or investment property other than a certificated security takes free of a security interest if the licensee or buyer gives value without knowledge of the security interest and before it is perfected.

Editor's note: This version of subsection (d) is effective until July 1, 2013.

(d) A licensee of a general intangible or a buyer, other than a secured party, of collateral other than tangible chattel paper, tangible documents, goods, instruments, or a certificated security takes free of a security interest if the licensee or buyer gives value without knowledge of the security interest and before it is perfected.

Editor's note: This version of subsection (d) is effective July 1, 2013.

(e) Except as otherwise provided in sections 4-9-320 and 4-9-321, if a person files a financing statement with respect to a purchase-money security interest before or within twenty days after the debtor receives delivery of the collateral, or if a person perfects under article 6 of title 42, C.R.S., a purchase-money security interest in a motor vehicle, other than inventory, before or within thirty days after the debtor receives delivery of the motor vehicle, the security interest takes priority over the rights of a buyer, lessee, or lien creditor which arise between the time the security interest attaches and the time of filing.

Source: L. 2001: Entire article R&RE, p. 1355, § 1, effective July 1. **L. 2006:** (b) and (d) amended, p. 502, § 42, effective September 1. **L. 2009:** (e) amended, (SB 09-150), ch. 182, p. 801, § 1, effective April 22. **L. 2012:** (b) and (d) amended, (HB 12-1262), ch. 170, p. 598, § 6, effective July 1, 2013.

Editor's note: (1) The provisions of this section are similar to former §§ 4-9-301 and 4-2.5-307 (2) as they existed prior to 2001.

(2) **Colorado legislative change:** In subsection (a)(2), Colorado did not adopt the phrases "the earlier of the time" after the word "before" and "or a financing statement covering the collateral is filed" at the end of the sentence.

OFFICIAL COMMENT

1. **Source.** Former Sections 9-301, 2A-307(2).

2. **Scope of This Section.** As did former Section 9-301, this section lists the classes of persons who take priority over, or take free of, an unperfected security interest. Section 9-308 explains when a security interest or agricultural lien is "perfected." A security interest that has attached (see Section 9-203) but as to which a required perfection step has not been taken is "unperfected." Certain provisions have been moved from former Section 9-301. The definition of "lien creditor" now appears in Section 9-102, and the rules governing priority in future advances are found in Section 9-323.

3. **Competing Security Interests.** Section 9-322 states general rules for determining priority among conflicting security interests and refers to other sections that state special rules of priority in a variety of situations. The security interests given priority under Section 9-322 and the other sections to which it refers take priority in general even over a perfected security interest. *A fortiori* they take priority over an unperfected security interest.

4. **Filed but Unattached Security Interest vs. Lien Creditor.** Under former Section 9-301(1)(b), a lien creditor's rights had priority over an unperfected security interest. Perfection required attachment (former Section 9-303), and attachment required the giving of value (former Section 9-203). It followed that, if a secured party had filed a financing statement, but the debtor had not entered into a security agreement and value had not yet been given, an intervening lien creditor whose lien arose after filing but before attachment of the security interest acquired rights that are senior to those of the secured party who later gives value. This result comported with the *nemo dat* concept: When the security interest attached, the collateral was already subject to the judicial lien.

On the other hand, this approach treated the first secured advance differently from all other advances, even in circumstances in which a security agreement covering the collateral had been entered into before the judicial lien attached. The special rule for future advances in former Section 9-301(4) (substantially reproduced in Section 9-323(b)) afforded priority to a discretionary advance made by a secured party within 45 days after the lien creditor's rights arose as long as the secured party was "perfected" when the lien creditor's lien arose i.e., as long as the advance was not the first one and an earlier advance had been made.

Subsection (a)(2) revises former Section 9-301(1)(b) and, in appropriate cases, treats the first advance the same as subsequent advances. More specifically, a judicial lien that arises after the security-agreement condition of Section 9-203(b)(3) is satisfied and a financing statement is filed, but before the security interest attaches and becomes perfected is subordinate to all advances secured by the security interest, even the first advance, except as otherwise provided in Section 9-323(b). However, if the security interest becomes unperfected (e.g., because the effectiveness of the filed financing statement lapses) before the judicial lien arises, the security interest is subordinate. If a financing statement is filed but a security interest does not attach, then no priority contest arises. The lien creditor has the only enforceable claim to the property.

5. **Security Interest of Consignor or Receivables Buyer vs. Lien Creditor.** Section 1-201(37) defines "security interest" to include the interest of most true consignors of goods and the interest of most buyers of certain receivables (accounts, chattel paper, payment intangibles, and promissory notes). A consignee of goods or a seller of accounts or chattel paper each is deemed to have rights in the collateral which a lien creditor may reach, as long as the competing security interest of the consignor or buyer is unperfected. This is so even though, as between the consignor and the debtor-consignee, the latter has only limited rights, and, as between the buyer and debtor-seller, the latter does not have any rights in the collateral. See Sections 9-318 (seller), 9-319 (consignee). Security interests arising from sales of payment intangibles and promissory notes are automatically perfected. See Section 9-309. Accordingly, a subsequent judicial lien always would be subordinate to the rights of a buyer of those types of receivables. **Note:** "Section 1-201(37)" will be replaced with "Section 1-201(b)(35)" effective July 1, 2013.

6. **Purchasers Other Than Secured Parties.** Subsections (b), (c), and (d) afford priority over an unperfected security interest to certain purchasers (other than secured parties) of collateral. They derive from former Sections 9-301(1)(c), 2A-307(2), and 9-301(d). Former Section 9-301(1)(c) and (1)(d) provided that unperfected security interests are "subordinate" to the rights of certain purchasers. But, as former Comment 9 suggested, the practical effect of subordination in this context is that the purchaser takes free of the security interest. To avoid any possible misinterpretation, subsections (b) and (d) of this section use the phrase "takes free."

Subsection (b) governs goods, as well as intangibles of the type whose transfer is effected by physical delivery of the representative piece of paper (tangible chattel paper, documents, instruments, and security certificates). To obtain priority, a buyer must both give value and receive delivery of the collateral without knowl-

edge of the existing security interest and before perfection. Even if the buyer gave value without knowledge and before perfection, the buyer would take subject to the security interest if perfection occurred before physical delivery of the collateral to the buyer. Subsection (c) contains a similar rule with respect to lessees of goods. Note that a lessee of goods in ordinary course of business takes free of all security interests created by the lessor, even if perfected. See Section 9-321.

Normally, there will be no question when a buyer of chattel paper, documents, instruments, or security certificates "receives delivery" of the property. See Section 1-201 (defining "delivery"). However, sometimes a buyer or lessee of goods, such as complex machinery, takes delivery of the goods in stages and completes assembly at its own location. Under those circumstances, the buyer or lessee "receives delivery" within the meaning of subsections (b) and (c) when, after an inspection of the portion of the goods remaining with the seller or lessor, it would be apparent to a potential lender to the seller or lessor that another person might have an interest in the goods.

The rule of subsection (b) obviously is not appropriate where the collateral consists of intangibles and there is no representative piece of paper whose physical delivery is the only or the customary method of transfer. Therefore, with respect to such intangibles ([including] accounts, electronic chattel paper, general intangibles, and investment property other than certificated securities), subsection (d) gives priority to any buyer who gives value without knowledge, and before perfection, of the security interest. A licensee of a general intangible takes free of an unperfected security interest in the general intangible under the same circumstances. Note that a licensee of a general intangible in ordinary course of business takes rights under a nonexclusive license free of security interests created by the licensor, even if perfected. See Section 9-321.

Note: The bracketed language takes effect July 1, 2013.

Unless Section 9-109 excludes the transaction from this Article, a buyer of accounts, chattel paper, payment intangibles, or promissory notes is a "secured party" (defined in Section 9-102), and subsections (b) and (d) do not determine priority of the security interest created by the sale. Rather, the priority rules generally applicable to competing security interests apply. See Section 9-322.

7. **Agricultural Liens.** Subsections (a), (b), and (c) subordinate unperfected agricultural liens in the same manner in which they subordinate unperfected security interests.

8. **Purchase-Money Security Interests.** Subsection (e) derives from former Section 9-301(2). It provides that, if a purchase-money security interest is perfected by filing no later than 20 days after the debtor receives delivery of the collateral, the security interest takes priority over the rights of buyers, lessees, or lien creditors which arise between the time the security interest attaches and the time of filing. Subsection (e) differs from former Section 9-301(2) in two significant respects. First, subsection (e) protects a purchase-money security interest against all buyers and lessees, not just against transferees in bulk. Second, subsection (e) conditions this protection on filing within 20, as opposed to ten, days after delivery.

Section 9-311(b) provides that compliance with the perfection requirements of a statute or treaty described in Section 9-311(a) "is equivalent to the filing of a financing statement." It follows that a person who perfects a security interest in goods covered by a certificate of title by complying with the perfection requirements of an applicable certificate-of-title statute "files a financing statement" within the meaning of subsection (e).

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "The Rights of Landlords in Tenants' Personal Property", see 57 Den. L.J. 685 (1980).

Annotator's note. Since § 4-9-317 is similar to § 4-9-301 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Reliance upon ownership of collateral by a debtor is not relevant to a determination of priority under the uniform commercial code, for there is no provision in the code for knowledge or reliance on ownership as a factor in determining the relative rights of secured creditors. Am. Nat'l Bank v. Magor, 28 Colo. App. 522, 476 P.2d 267 (1970).

Paramount status accorded to first to file. The drafters of the code, by their emphasis on procedural rigidity, accorded paramount status to the secured creditor first to file. Am. Nat'l Bank v. Magor, 28 Colo. App. 522, 476 P.2d 267 (1970).

An unperfected security interest becomes subordinate to the rights acquired by a lien creditor when a writ of garnishment is served on the garnishee at a time when the garnishor has no notice of the security interest. Welbourne Dev. Co. v. Affiliated Clearance Corp., 28 Colo. App. 313, 472 P.2d 684 (1970).

Subsection (4) was adopted to address issues relating to advances made under a per-

fected security interest and federal tax liens. ITT Diversified Credit Corp. v. Couch, 669 P.2d 1355 (Colo. 1983).

Security agreement in nature of chattel mortgage creates lien for the benefit of the secured party and title reposes in the debtor or mortgagor, in the absence of a contrary contractual provision. People ex rel. VanMeveren v. District Court, 619 P.2d 494 (Colo. 1980).

Code specifies which interests take priority over an unperfected security interest, and where the seller's interest or right in the goods does not fall within any of those specified interests, its right to reclaim the goods does not take priority over a bank's unperfected security interest. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 32 Colo. App. 235, 511 P.2d 912 (1973), aff'd, 184 Colo. 166, 519 P.2d 354 (1974).

Right to reclaim goods is not one of the interests so specified. The right to reclaim goods conveyed as part of a cash sale transaction is not one of the interests which is listed as having priority over an unperfected security interest. Guy Martin Buick, Inc. v. Colo. Springs Nat'l Bank, 184 Colo. 166, 519 P.2d 354 (1974).

Priority of judicial lien rules. A perfected security interest securing an obligation that was undertaken by debtor before creation of a judicial lien took priority over the lien even if such obligation did not become due until after the lien's creation. Alling v. Am. Tool & Grinding Co., Inc., 648 F. Supp. 1344 (D. Colo. 1986).

A creditor who holds a perfected security interest in collateral can be held liable to an unsecured creditor for benefits that enhance the value of the secured collateral on the basis of unjust enrichment, even where holding the secured creditor liable alters the priority system set forth in this section. The standard for determining whether a secured creditor is unjustly enriched as a result of benefits conferred by the unsecured creditor is the extent to which the secured creditor was involved in the transactions through which the unsecured creditor supplied goods or services that enhanced the value of the collateral. Ninth Dist. Prod. Credit v. Ed Duggan, 821 P.2d 788 (Colo. 1991).

Creditor's unperfected security interest is not subordinate to interest of creditors who had actual knowledge of such security interest. Although creditor failed to note his security interest on the certificate of title for certain vehicles, party who assumes the obligations under an indenture and security agreement takes title to property subject to such security interest. Vance v. Casebolt, 841 P.2d 394 (Colo. App. 1992).

The Colorado Certificate of Title Act (CCTA) does not supersede subsection (e) of this section because subsection (e) does not govern the manner or timing of the perfection of liens. It governs only the priority of a lien and is not inconsistent with the CCTA. In re Roser, 613 F.3d 1240 (10th Cir. 2010).

Applied in Rocky Mt. Ass'n of Credit Mgt. v. Hessler Mfg. Co., 37 Colo. App. 551, 553 P.2d 840 (1976); Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977); Bd. of County Comm'rs v. Berkeley Vill., 40 Colo. App. 431, 580 P.2d 1251 (1978); Dept. of Natural Res. v. Benjamin, 41 Colo. App. 520, 587 P.2d 1207 (1978); Young v. Golden State Bank, 632 P.2d 1053 (Colo. App. 1981); Heinrichsdorff v. Raat, 655 P.2d 860 (Colo. App. 1982); Yeager Trucking v. Circle Leasing, 29 Bankr. 131 (Bankr. D. Colo. 1983).

4-9-318. No interest retained in right to payment that is sold - rights and title of seller of account or chattel paper with respect to creditors and purchasers. (a) A debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain a legal or equitable interest in the collateral sold.

(b) For purposes of determining the rights of creditors of, and purchasers for value of an account or chattel paper from, a debtor that has sold an account or chattel paper, while the buyer's security interest is unperfected, the debtor is deemed to have rights and title to the account or chattel paper identical to those the debtor sold.

Source: L. 2001: Entire article R&RE, p. 1356, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Sellers of Accounts, Chattel Paper, Payment Intangibles, and Promissory Notes.** Section 1-201(37) defines "security interest" to include the interest of a buyer of accounts, chattel paper, payment intangibles, or promissory notes. See also Section 9-109(a) and Comment 5. Subsection (a) makes explicit what was implicit, but perfectly obvious, under former Article 9: The fact that a sale of an account or chattel paper gives rise to a "security interest" does not imply that the seller retains an interest in the property that has been sold. To the contrary, a seller of an account or chattel paper retains no interest whatsoever in the property to the extent that it has been sold. Subsection (a) also applies to sales of payment intangibles and promissory notes, transactions that were not covered by former

Article 9. Neither this Article nor the definition of "security interest" in Section 1-201 provides rules for distinguishing sales transactions from those that create a security interest securing an obligation.
Note: "1-201(37)" in the first sentence will be replaced with "1-201(b)(35)" effective July 1, 2013.

3. **Buyers of Accounts and Chattel Paper.** Another aspect of sales of accounts and chattel paper also was implicit, and equally obvious, under former Article 9: If the buyer's security interest is unperfected, then for purposes of determining the rights of certain third parties, the seller (debtor) is deemed to have all rights and title that the seller sold. The seller is deemed to have these rights even though, as between the parties, it has sold all its rights to the buyer. Subsection (b) makes this explicit. As a consequence of subsection (b), if the buyer's security interest is unperfected, the seller can transfer, and the creditors of the seller can reach, the account or chattel paper as if it had not been sold.

Example: Debtor sells accounts or chattel paper to Buyer-1 and retains no interest in them. Buyer-1 does not file a financing statement. Debtor then sells the same receivables to Buyer-2. Buyer-2 files a proper financing statement. Having sold the receivables to Buyer-1, Debtor would not have any rights in the collateral so as to permit Buyer-2's security (ownership) interest to attach. Nevertheless, under this section, for purposes of determining the rights of purchasers for value from Debtor, Debtor is deemed to have the rights that Debtor sold. Accordingly, Buyer-2's security interest attaches, is perfected by the filing, and, under Section 9-322, is senior to Buyer-1's interest.

4. **Effect of Perfection.** If the security interest of a buyer of accounts or chattel paper is perfected the usual result would take effect: transferees from and creditors of the seller could not acquire an interest in the sold accounts or chattel paper. The same result would generally occur if payment intangibles or promissory notes were sold, inasmuch as the buyer's security interest is automatically perfected under Section 9-309. However, in certain circumstances, a purchaser who takes possession of a promissory note will achieve priority, under Sections 9-330 or 9-331, over the security interest of an earlier buyer of the promissory note. It necessarily follows that the seller in those circumstances retains the power to transfer the promissory note, as if it had not been sold, to a purchaser who obtains priority under either of those sections. See Section 9- 203(b)(3), Comment 6.

4-9-319. Rights and title of consignee with respect to creditors and purchasers. (a) Except as otherwise provided in subsection (b) of this section, for purposes of determining the rights of creditors of, and purchasers for value of goods from, a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to transfer.

(b) For purposes of determining the rights of a creditor of a consignee, law other than this article determines the rights and title of a consignee while goods are in the consignee's possession if, under this part 3, a perfected security interest held by the consignor would have priority over the rights of the creditor.

Source: L. 2001: Entire article R&RE, p. 1356, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Consignments.** This section takes an approach to consignments similar to that taken by Section 9-318 with respect to buyers of accounts and chattel paper. Revised Section 1-201(37) defines "security interest" to include the interest of a consignor of goods under many true consignments. Section 9-319(a) provides that, for purposes of determining the rights of certain third parties, the consignee is deemed to acquire all rights and title that the consignor had, if the consignor's security interest is unperfected. The consignee acquires these rights even though, as between the parties, it purchases a limited interest in the goods (as would be the case in a true consignment, under which the consignee acquires only the interest of a bailee). As a consequence of this section, creditors of the consignee can acquire judicial liens and security interests in the goods.
Note: "1-201(37)" in the second sentence will be replaced with "1-201(b)(35)" effective July 1, 2013.

Insofar as creditors of the consignee are concerned, this Article to a considerable extent reformulates the former law, which appeared in former Sections 2-326 and 9-114, without changing the results. However, neither Article 2 nor former Article 9 specifically addresses the rights of non-ordinary course buyers from the consignee. Former Section 9-114 contained priority rules applicable to security interests in consigned goods. Under this Article, the priority rules for purchase-money security interests in

inventory apply to consignments. See Section 9-103(d). Accordingly, a special section containing priority rules for consignments no longer is needed. Section 9-317 determines whether the rights of a judicial lien creditor are senior to the interest of the consignor, Sections 9-322 and 9-324 govern competing security interests in consigned goods, and Sections 9- 317, 9-315, and 9-320 determine whether a buyer takes free of the consignor's interest.

The following example explains the operation of this section:

Example 1: SP-1 delivers goods to Debtor in a transaction constituting a "consignment" as defined in Section 9-102. SP-1 does not file a financing statement. Debtor then grants a security interest in the goods to SP-2. SP-2 files a proper financing statement. Assuming Debtor is a mere bailee, as in a "true" consignment, Debtor would not have any rights in the collateral (beyond those of a bailee) so as to permit SP-2's security interest to attach to any greater rights. Nevertheless, under this section, for purposes of determining the rights of Debtor's creditors, Debtor is deemed to acquire SP-1's rights. Accordingly, SP-2's security interest attaches, is perfected by the filing, and, under Section 9-322, is senior to SP-1's interest.

3. **Effect of Perfection.** Subsection (b) contains a special rule with respect to consignments that are perfected. If application of this Article would result in the consignor having priority over a competing creditor, then other law determines the rights and title of the consignee.

Example 2: SP-1 delivers goods to Debtor in a transaction constituting a "consignment" as defined in Section 9-102. SP-1 files a proper financing statement. Debtor then grants a security interest in the goods to SP-2. Under Section 9-322, SP-1's security interest is senior to SP-2's. Subsection (b) indicates that, for purposes of determining SP-2's rights, other law determines the rights and title of the consignee. If, for example, a consignee obtains only the special property of a bailee, then SP-2's security interest would attach only to that special property.

Example 3: SP-1 obtains a security interest in all Debtor's existing and after-acquired inventory. SP-1 perfects its security interest with a proper filing. Then SP-2 delivers goods to Debtor in a transaction constituting a "consignment" as defined in Section 9-102. SP-2 files a proper financing statement but does not send notification to SP-1 under Section 9- 324(b). Accordingly, SP-2's security interest is junior to SP-1's under Section 9-322(a). Under Section 9-319(a), Debtor is deemed to have the consignor's rights and title, so that SP- 1's security interest attaches to SP-2's ownership interest in the goods. Thereafter, Debtor grants a security interest in the goods to SP-3, and SP-3 perfects by filing. Because SP-2's perfected security interest is senior to SP-3's under Section 9-322(a), Section 9-319(b) applies: Other law determines Debtor's rights and title to the goods insofar as SP-3 is concerned, and SP-3's security interest attaches to those rights.

4-9-320. Buyer of goods. (a) Except as otherwise provided in subsection (e) of this section, a buyer in ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.

(b) Except as otherwise provided in subsection (e) of this section, a buyer of goods from a person who used or bought the goods for use primarily for personal, family, or household purposes takes free of a security interest, even if perfected, if the buyer buys:

(1) Without knowledge of the security interest;

(2) For value;

(3) Primarily for the buyer's personal, family, or household purposes; and

(4) Before the filing of a financing statement covering the goods.

(c) To the extent that it affects the priority of a security interest over a buyer of goods under subsection (b) of this section, the period of effectiveness of a filing made in the jurisdiction in which the seller is located is governed by section 4-9-316 (a) and (b).

(d) A buyer in ordinary course of business buying oil, gas, or other minerals at the wellhead or minehead or after extraction takes free of an interest arising out of an encumbrance.

(e) Subsections (a) and (b) of this section do not affect a security interest in goods in the possession of the secured party under section 4-9-313.

Source: L. 2001: Entire article R&RE, p. 1356, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-307 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-307.

2. **Scope of This Section.** This section states when buyers of goods take free of a security interest even though perfected. Of course, a buyer who takes free of a perfected security interest takes free of an unperfected one. Section 9-317 should be consulted to determine what purchasers, in addition to the buyers covered in this section, take free of an unperfected security interest. Article 2 states general rules on purchase of goods from a seller with defective or voidable title (Section 2-403).

3. **Buyers in Ordinary Course.** Subsection (a) derives from former Section 9- 307(1). The definition of "buyer in ordinary course of business" in Section 1-201 restricts its application to buyers "from a person, other than a pawnbroker, in the business of selling goods of that kind." Thus subsection (a) applies primarily to inventory collateral. The subsection further excludes from its operation buyers of "farm products"(defined in Section 9-102) from a person engaged in farming operations. The buyer in ordinary course of business is defined as one who buys goods "in good faith, without knowledge that the sale violates the rights of another person and in the ordinary course." Subsection (a) provides that such a buyer takes free of a security interest, even though perfected, and even though the buyer knows the security interest exists. Reading the definition together with the rule of law results in the buyer's taking free if the buyer merely knows that a security interest covers the goods but taking subject if the buyer knows, in addition, that the sale violates a term in an agreement with the secured party.

As did former Section 9-307(1), subsection (a) applies only to security interests created by the seller of the goods to the buyer in ordinary course. However, under certain circumstances a buyer in ordinary course who buys goods that were encumbered with a security interest created by a person other than the seller may take free of the security interest, as Example 2 explains. See also Comment 6, below.

Example 1: Manufacturer, who is in the business of manufacturing appliances, owns manufacturing equipment subject to a perfected security interest in favor of Lender. Manufacturer sells the equipment to Dealer, who is in the business of buying and selling used equipment. Buyer buys the equipment from Dealer. Even if Buyer qualifies as a buyer in the ordinary course of business, Buyer does not take free of Lender's security interest under subsection (a), because Dealer did not create the security interest; Manufacturer did.

Example 2: Manufacturer, who is in the business of manufacturing appliances, owns manufacturing equipment subject to a perfected security interest in favor of Lender. Manufacturer sells the equipment to Dealer, who is in the business of buying and selling used equipment. Lender learns of the sale but does nothing to assert its security interest. Buyer buys the equipment from Dealer. Inasmuch as Lender's acquiescence constitutes an "entrusting" of the goods to Dealer within the meaning of Section 2-403(3) Buyer takes free of Lender's security interest under Section 2-403(2) if Buyer qualifies as a buyer in ordinary course of business.

4. **Buyers of Farm Products.** This section does not enable a buyer of farm products to take free of a security interest created by the seller, even if the buyer is a buyer in ordinary course of business. However, a buyer of farm products may take free of a security interest under Section 1324 of the Food Security Act of 1985, 7 U.S.C. § 1631.

5. **Buyers of Consumer Goods.** Subsection (b), which derives from former Section 9-307(2), deals with buyers of collateral that the debtor-seller holds as "consumer goods" (defined in Section 9-102). Under Section 9-309(1), a purchase-money interest in consumer goods, except goods that are subject to a statute or treaty described in Section 9-311(a) (such as automobiles that are subject to a certificate-of-title statute), is perfected automatically upon attachment. There is no need to file to perfect. Under subsection (b) a buyer of consumer goods takes free of a security interest, even though perfected, if the buyer buys (1) without knowledge of the security interest, (2) for value, (3) primarily for the buyer's own personal, family, or household purposes, and (4) before a financing statement is filed.

As to purchase money-security interests which are perfected without filing under Section 9-309(1): A secured party may file a financing statement, although filing is not required for perfection. If the secured party does file, all buyers take subject to the security interest. If the secured party does not file, a buyer who meets the qualifications stated in the preceding paragraph takes free of the security interest.

As to security interests for which a perfection step is required: This category includes all non-purchase-money security interests, and all security interests, whether or not purchase-money, in goods subject to a statute or treaty described in Section 9-311(a), such as automobiles covered by a certificate-of-title statute. As long as the required perfection step has not been taken and the security interest remains unperfected, not only the buyers described in subsection (b) but also the purchasers described in Section 9-317 will take free of the security interest. After a financing statement has been filed or the perfection requirements of the applicable certificate-of-title statute have been complied with (compliance is the equivalent of filing a financing

statement; see Section 9-311(b)), all subsequent buyers, under the rule of subsection (b), are subject to the security interest.

The rights of a buyer under subsection (b) turn on whether a financing statement has been filed against consumer goods. Occasionally, a debtor changes his or her location after a filing is made. Subsection (c), which derives from former Section 9-103(1)(d)(iii), deals with the continued effectiveness of the filing under those circumstances. It adopts the rules of Sections 9-316(a) and (b). These rules are explained in the Comments to that section.

6. **Authorized Dispositions.** The limitations that subsections (a) and (b) impose on the persons who may take free of a security interest apply of course only to unauthorized sales by the debtor. If the secured party authorized the sale in an express agreement or otherwise, the buyer takes free under Section 9-315(a) without regard to the limitations of this section. (That section also states the right of a secured party to the proceeds of a sale, authorized or unauthorized.) Moreover, the buyer also takes free if the secured party waived or otherwise is precluded from asserting its security interest against the buyer. See Section 1-103.

7. **Oil, Gas, and Other Minerals.** Under subsection (d), a buyer in ordinary course of business of minerals at the wellhead or minehead or after extraction takes free of a security interest created by the seller. Specifically, it provides that qualified buyers take free not only of Article 9 security interests but also of interests "arising out of an encumbrance." As defined in Section 9-102, the term "encumbrance" means "a right, other than an ownership interest, in real property." Thus, to the extent that a mortgage encumbers minerals not only before but also after extraction, subsection (d) enables a buyer in ordinary course of the minerals to take free of the mortgage. This subsection does not, however, enable these buyers to take free of interests arising out of ownership interests in the real property. This issue is significant only in a minority of states. Several of them have adopted special statutes and nonuniform amendments to Article 9 to provide special protections to mineral owners, whose interests often are highly fractionalized in the case of oil and gas. See Terry I. Cross, *Oil and Gas Product Liens—Statutory Security Interests for Producers and Royalty Owners Under the Statutes of Kansas, New Mexico, Oklahoma, Texas and Wyoming,* 50 Consumer Fin. L. Q. Rep. 418 (1996). Inasmuch as a complete resolution of the issue would require the addition of complex provisions to this Article, and there are good reasons to believe that a uniform solution would not be feasible, this Article leaves its resolution to other legislation.

8. **Possessory Security Interests.** Subsection (e) is new. It rejects the holding of *Tanbro Fabrics Corp. v. Deering Milliken, Inc.,* 350 N.E.2d 590 (N.Y. 1976) and, together with Section 9-317(b), prevents a buyer of goods collateral from taking free of a security interest if the collateral is in the possession of the secured party. "The secured party" referred in subsection (e) is the holder of the security interest referred to in subsection (a) or (b). Section 9-313 determines whether a secured party is in possession for purposes of this section. Under some circumstances, Section 9-313 provides that a secured party is in possession of collateral even if the collateral is in the physical possession of a third party.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Agricultural Lending in a Troubled Economy", see 16 Colo. Law. 1773 (1987).

Annotator's note. Since § 4-9-320 is similar to § 4-9-307 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Limits on purchasers taking free of security interest qualified by comment. Although this section limits the situations in which certain purchasers take free of security interests, the last paragraph under "Official Comment 2" to this section qualifies this limitation. Farmers Nat'l Bank v. Ceres Land Co., 32 Colo. App. 290, 512 P.2d 1174 (1973).

Applied in First Nat'l Bank v. Bostron, 39 Colo. App. 107, 564 P.2d 964 (1977); Western Nat'l Bank v. ABC Drilling Co., 42 Colo. App. 407, 599 P.2d 942 (1979).

4-9-321. Licensee of general intangible and lessee of goods in ordinary course of business. (a) In this section, "licensee in ordinary course of business" means a person that becomes a licensee of a general intangible in good faith, without knowledge that the license violates the rights of another person in the general intangible, and in the ordinary course from a person in the business of licensing general intangibles of that kind. A person becomes a licensee in the ordinary course if the license to the person comports with the

usual or customary practices in the kind of business in which the licensor is engaged or with the licensor's own usual or customary practices.

(b) A licensee in ordinary course of business takes its rights under a nonexclusive license free of a security interest in the general intangible created by the licensor, even if the security interest is perfected and the licensee knows of its existence.

(c) A lessee in ordinary course of business takes its leasehold interest free of a security interest in the goods created by the lessor, even if the security interest is perfected and the lessee knows of its existence.

Source: L. 2001: Entire article R&RE, p. 1357, § 1, effective July 1.

Editor's note: The provisions of this section are similar to former §§ 4-2.5-103 (1)(o) and 4-2.5-307 (3) as they existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Derived from Sections 2A-103(1)(o), 2A-307(3).

2. **Licensee in Ordinary Course.** Like the analogous rules in Section 9-320(a) with respect to buyers in ordinary course and subsection (c) with respect to lessees in ordinary course, the new rule in subsection (b) reflects the expectations of the parties and the marketplace: a licensee under a nonexclusive license takes subject to a security interest unless the secured party authorizes the license free of the security interest or other, controlling law such as that of this section (protecting ordinary-course licensees) dictates a contrary result. See Sections 9-201, 9-315. The definition of "licensee in ordinary course of business" in subsection (a) is modeled upon that of "buyer in ordinary course of business."

3. **Lessee in Ordinary Course.** Subsection (c) contains the rule formerly found in Section 2A-307(3). The rule works in the same way as that of Section 9-320(a).

4-9-322. Priorities among conflicting security interests in and agricultural liens on same collateral. (a) Except as otherwise provided in this section, priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules:

(1) Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection.

(2) A perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien.

(3) The first security interest or agricultural lien to attach or become effective has priority if conflicting security interests and agricultural liens are unperfected.

(b) For the purposes of paragraph (1) of subsection (a) of this section:

(1) The time of filing or perfection as to a security interest in collateral is also the time of filing or perfection as to a security interest in proceeds; and

(2) The time of filing or perfection as to a security interest in collateral supported by a supporting obligation is also the time of filing or perfection as to a security interest in the supporting obligation.

(c) Except as otherwise provided in subsection (f) of this section, a security interest in collateral which qualifies for priority over a conflicting security interest under section 4-9-327, 4-9-328, 4-9-329, 4-9-330, or 4-9-331 also has priority over a conflicting security interest in:

(1) Any supporting obligation for the collateral; and

(2) Proceeds of the collateral if:

(A) The security interest in proceeds is perfected;

(B) The proceeds are cash proceeds or of the same type as the collateral; and

(C) In the case of proceeds that are proceeds of proceeds, all intervening proceeds are cash proceeds, proceeds of the same type as the collateral, or an account relating to the collateral.

(d) Subject to subsection (e) of this section and except as otherwise provided in subsection (f) of this section, if a security interest in chattel paper, deposit accounts, negotiable documents, instruments, investment property, or letter-of-credit rights is perfected by a method other than filing, conflicting perfected security interests in proceeds of the collateral rank according to priority in time of filing.

(e) Subsection (d) of this section applies only if the proceeds of the collateral are not cash proceeds, chattel paper, negotiable documents, instruments, investment property, or letter-of-credit rights.

(f) Subsections (a) to (e) of this section are subject to:

(1) Subsection (g) of this section and the other provisions of this part 3;

(2) Section 4-4-210 with respect to a security interest of a collecting bank;

(3) Section 4-5-117.5 with respect to a security interest of an issuer or nominated person; and

(4) Section 4-9-110 with respect to a security interest arising under article 2 or 2.5 of this title.

(g) A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides.

Source: L. 2001: Entire article R&RE, p. 1357, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-312 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-312(5), (6).

2. **Scope of This Section.** In a variety of situations, two or more people may claim a security interest in the same collateral. This section states general rules of priority among conflicting security interests. As subsection (f) provides, the general rules in subsections (a) through (e) are subject to the rule in subsection (g) governing perfected agricultural liens and to the other rules in this Part of this Article. Rules that override this section include those applicable to purchase- money security interests (Section 9-324) and those qualifying for special priority in particular types of collateral. See, e.g., Section 9-327 (deposit accounts); Section 9-328 (investment property); Section 9-329 (letter-of-credit rights); Section 9-330 (chattel paper and instruments); Section 9-334 (fixtures). In addition, the general rules of sections (a) through (e) are subject to priority rules governing security interests arising under Articles 2, 2A, 4, and 5.

3. **General Rules.** Subsection (a) contains three general rules. Subsection (a)(1) governs the priority of competing perfected security interests. Subsection (a)(2) governs the priority of competing security interests if one is perfected and the other is not. Subsection (a)(3) governs the priority of competing unperfected security interests. The rules may be regarded as adaptations of the idea, deeply rooted at common law, of a race of diligence among creditors. The first two rules are based on precedence in the time as of which the competing secured parties either filed their financing statements or obtained perfected security interests. Under subsection (a)(1), the first secured party who files or perfects has priority. Under subsection (a)(2), which is new, a perfected security interest has priority over an unperfected one. Under subsection (a)(3), if both security interests are unperfected, the first to attach has priority. Note that Section 9-709(b) may affect the application of subsection (a) to a filing that occurred before the effective date of this Article and which would be ineffective to perfect a security interest under former Article 9 but effective under this Article.

4. **Competing Perfected Security Interests.** When there is more than one perfected security interest, the security interests rank according to priority in time of filing or perfection. "Filing," of course, refers to the filing of an effective financing statement. "Perfection" refers to the acquisition of a perfected security interest, i.e., one that has attached and as to which any required perfection step has been taken. See Sections 9-308 and 9-309.

Example 1: On February 1, A files a financing statement covering a certain item of Debtor's equipment. On March 1, B files a financing statement covering the same equipment. On April 1, B makes a loan to Debtor and obtains a security interest in the equipment. On May 1, A makes a loan to Debtor and obtains a security interest in the same collateral. A has priority even though B's loan was made earlier and was perfected when made. It makes no difference whether A knew of B's security interest when A made its advance.

The problem stated in Example 1 is peculiar to a notice-filing system under which filing may

occur before the security interest attaches (see Section 9-502). The justification for determining priority by order of filing lies in the necessity of protecting the filing system that is, of allowing the first secured party who has filed to make subsequent advances without each time having to check for subsequent filings as a condition of protection. Note, however, that this first-to-file protection is not absolute. For example, Section 9-324 affords priority to certain purchase-money security interests, even if a competing secured party was the first to file or perfect.

[Under a notice-filing system, a filed financing statement indicates to third parties that a person may have a security interest in the collateral indicated. With further inquiry, they may discover the complete state of affairs. When a financing statement that is ineffective when filed becomes effective thereafter, the policy underlying the notice-filing system determines the "time of filing" for purposes of subsection (a)(1). For example, the unauthorized filing of an otherwise sufficient initial financing statement becomes authorized, and the financing statement becomes effective, upon the debtor's post-filing authorization or ratification of the filing. See Section 9-509, Comment 3. Because the notice value of the financing statement is independent of the timing of authorization or ratification, the time of the unauthorized filing is the "time of filing" for purposes of subsection (a)(1). The same policy applies to the other priority rules in this part.]

Note: The bracketed language takes effect July 1, 2013.

Example 2: A and B make non-purchase-money advances secured by the same collateral. The collateral is in Debtor's possession, and neither security interest is perfected when the second advance is made. Whichever secured party first perfects its security interest (by taking possession of the collateral or by filing) takes priority. It makes no difference whether that secured party knows of the other security interest at the time it perfects its own.

The rule of subsection (a)(1), affording priority to the first to file or perfect, applies to security interests that are perfected by any method, including temporarily (Section 9-312) or upon attachment (Section 9-309), even though there may be no notice to creditors or subsequent purchasers and notwithstanding any common-law rule to the contrary. The form of the claim to priority, i.e., filing or perfection, may shift from time to time, and the rank will be based on the first filing or perfection as long as there is no intervening period without filing or perfection. See Section 9-308(c).

Example 3: On October 1, A acquires a temporarily perfected (20-day) security interest, unfiled, in a negotiable document in the debtor's possession under Section 9-312(e). On October 5, B files and thereby perfects a security interest that previously had attached to the same document. On October 10, A files. A has priority, even after the 20-day period expires, regardless of whether A knows of B's security interest when A files. A was the first to perfect and maintained continuous perfection or filing since the start of the 20-day period. However, the perfection of A's security interest extends only "to the extent it arises for new value given." To the extent A's security interest secures advances made by A beyond the 20- day period, its security interest would be subordinate to B's, inasmuch as B was the first to file.

In general, the rule in subsection (a)(1) does not distinguish among various advances made by a secured party. The priority of every advance dates from the earlier of filing or perfection. However, in rare instances, the priority of an advance dates from the time the advance is made. See Example 3 and Section 9-323.

5. **Priority in After-Acquired Property.** The application of the priority rules to after-acquired property must be considered separately for each item of collateral. Priority does not depend only on time of perfection but may also be based on priority in filing before perfection.

Example 4: On February 1, A makes advances to Debtor under a security agreement covering "all Debtor's machinery, both existing and after-acquired." A promptly files a financing statement. On April 1, B takes a security interest in all Debtor's machinery, existing and after-acquired, to secure an outstanding loan. The following day, B files a financing statement. On May 1, Debtor acquires a new machine. When Debtor acquires rights in the new machine, both A and B acquire security interests in the machine simultaneously. Both security interests are perfected simultaneously. However, A has priority because A filed before B.

When after-acquired collateral is encumbered by more than one security interest, one of the security interests often is a purchase-money security interest that is entitled to special priority under Section 9-324.

6. **Priority in Proceeds: General Rule.** Subsection (b)(1) follows former Section 9-312(6). It provides that the baseline rules of subsection (a) apply generally to priority conflicts in proceeds except where otherwise provided (e.g., as in subsections (c) through (e)). Under Section 9-203, attachment cannot occur (and therefore, under Section 9-308, perfection cannot occur) as to particular collateral until the collateral itself comes into existence and the debtor has rights in it. Thus, a security interest in proceeds of original collateral does not attach and is not perfected until the proceeds come into existence and the debtor acquires rights in them.

Example 5: On April 1, Debtor authenticates a security agreement granting to A a security interest in all Debtor's existing and after-acquired inventory. The same day, A files a financ-

ing statement covering inventory. On May 1, Debtor authenticates a security agreement granting B a security interest in all Debtor's existing and future accounts. On June 1, Debtor sells inventory to a customer on 30-day unsecured credit. When Debtor acquires the account, B's security interest attaches to it and is perfected by B's financing statement. At the very same time, A's security interest attaches to the account as proceeds of the inventory and is automatically perfected. See Section 9-315. Under subsection (b) of this section, for purposes of determining A's priority in the account, the time of filing as to the original collateral (April 1, as to inventory) is also the time of filing as to proceeds (account). Accordingly, A's security interest in the account has priority over B's. Of course, had B filed its financing statement before A filed (e.g., on March 1), then B would have priority in the accounts.

Section 9-324 governs the extent to which a special purchase-money priority in goods or software carries over into the proceeds of the original collateral.

7. **Priority in Proceeds: Special Rules.** Subsections (c), (d), and (e), which are new, provide additional priority rules for proceeds of collateral in situations where the temporal (first-in-time) rules of subsection (a)(1) are not appropriate. These new provisions distinguish what these Comments refer to as "non-filing collateral" from what they call "filing collateral." As used in these Comments, non-filing collateral is collateral of a type for which perfection may be achieved by a method other than filing (possession or control, mainly) and for which secured parties who so perfect generally do not expect or need to conduct a filing search. More specifically, non-filing collateral is chattel paper, deposit accounts, negotiable documents, instruments, investment property, and letter-of-credit rights. Other collateral accounts, commercial tort claims, general intangibles, goods, nonnegotiable documents, and payment intangibles is filing collateral.

8. **Proceeds of Non-Filing Collateral: Non-Temporal Priority.** Subsection (c)(2) provides a baseline priority rule for proceeds of non-filing collateral which applies if the secured party has taken the steps required for non-temporal priority over a conflicting security interest in non-filing collateral (e.g., control, in the case of deposit accounts, letter-of-credit rights, and investment property). This rule determines priority in proceeds of non-filing collateral whether or not there exists an actual conflicting security interest in the original non-filing collateral. Under subsection (c)(2), the priority in the original collateral continues in proceeds if the security interest in proceeds is perfected and the proceeds are cash proceeds or non-filing proceeds "of the same type" as the original collateral. As used in subsection (c)(2), "type" means a type of collateral defined in the Uniform Commercial Code and should be read broadly. For example, a security is "of the same type" as a security entitlement (i.e., investment property), and a promissory note is "of the same type" as a draft (i.e., an instrument).

Example 6: SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security. Debtor receives cash proceeds of the security (e.g., dividends deposited into Debtor's deposit account). If the first-to-file-or- perfect rule of subsection (a)(1) were applied, SP-1's security interest in the cash proceeds would be senior, although SP-2's security interest continues perfected under Section 9-315 beyond the 20-day period of automatic perfection. This was the result under former Article 9. Under subsection (c), however, SP-2's security interest is senior.

Note that a different result would obtain in Example 6 (i.e., SP-1's security interest would be senior) if SP-1 were to obtain control of the deposit-account proceeds. This is so because subsection (c) is subject to subsection (f), which in turn provides that the priority rules under subsections (a) through (e) are subject to "the other provisions of this part." One of those "other provisions" is Section 9-327, which affords priority to a security interest perfected by control. See Section 9-327(1).

Example 7: SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security. Debtor receives proceeds of the security consisting of a new certificated security issued as a stock dividend on the original collateral. Although the new security is of the same type as the original collateral (i.e., investment property), once the 20-day period of automatic perfection expires (see Section 9-315(d)), SP-2's security interest is unperfected. (SP-2 has not filed or taken delivery or control, and no temporary-perfection rule applies.) Consequently, once the 20-day period expires, subsection (c) does not confer priority, and, under subsection (a)(2), SP-1's security interest in the security is senior. This was the result under former Article 9.

Example 8: SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security and also by filing against investment property. Debtor receives proceeds of the security consisting of a new certificated security issued as a stock dividend of the collateral. Because the new security is of the same type as the original collateral (i.e., investment property) and (unlike Example 7) SP-2's security interest is perfected by filing, SP-2's security interest is senior under subsection (c). If the new security were redeemed by the issuer upon surrender and yet another security were received by Debtor,

SP-2's security interest would continue to enjoy priority under subsection (c). The new security would be proceeds of proceeds.

Example 9: SP-1 perfects its security interest in investment property by filing. SP-2 subsequently perfects its security interest in investment property by taking control of a certificated security and also by filing against investment property. Debtor receives proceeds of the security consisting of a dividend check that it deposits to a deposit account. Because the check and the deposit account are cash proceeds, SP-1's and SP-2's security interests in the cash proceeds are perfected under Section 9-315 beyond the 20-day period of automatic perfection. However, SP-2's security interest is senior under subsection (c).

Example 10: SP-1 perfects its security interest in investment property by filing. SP-2 perfects subsequently by taking control of a certificated security and also by filing against investment property. Debtor receives an instrument as proceeds of the security. (Assume that the instrument is not cash proceeds.) Because the instrument is not of the same type as the original collateral (i.e., investment property), SP-2's security interest, although perfected by filing, does not achieve priority under subsection (c). Under the first-to-file-or-perfect rule of subsection (a)(1), SP-1's security interest in the proceeds is senior.

The proceeds of proceeds are themselves proceeds. See Section 9-102 (defining "proceeds" and "collateral"). Sometimes competing security interests arise in proceeds that are several generations removed from the original collateral. As the following example explains, the applicability of subsection (c) may turn on the nature of the intervening proceeds.

Example 11: SP-1 perfects its security interest in Debtor's deposit account by obtaining control. Thereafter, SP-2 files against inventory, (presumably) searches, finds no indication of a conflicting security interest, and advances against Debtor's existing and after-acquired inventory. Debtor uses funds from the deposit account to purchase inventory, which SP-1 can trace as identifiable proceeds of its security interest in Debtor's deposit account, and which SP-2 claims as original collateral. The inventory is sold and the proceeds deposited into *another* deposit account, as to which SP-1 has not obtained control. Subsection (c) does not govern priority in this other deposit account. This deposit account is cash proceeds and is also the same type of collateral as SP-1's original collateral, as required by subsections (c)(2)(A) and (B). However, SP-1's security interest does not satisfy subsection (c)(2)(C) because the inventory proceeds, which intervened between the original deposit account and the deposit account constituting the proceeds at issue, are not cash proceeds, proceeds of the same type as the collateral (original deposit account), or an account relating to the collateral. Stated otherwise, once proceeds other than cash proceeds, proceeds of the same type as the original collateral, or an account relating to the original collateral intervene in the chain of proceeds, priority under subsection (c) is thereafter unavailable. The special priority rule in subsection (d) also is inapplicable to this case. See Comment 9, Example 13, below. Instead, the general first-to-file-or-perfect rule of subsections (a) and (b) apply. Under that rule, SP-1 has priority unless its security interest in the inventory proceeds became unperfected under Section 9-315(d). Had SP-2 filed against inventory before SP-1 obtained control of the original deposit account, then SP-2 would have had priority even if SP-1's security interest in the inventory proceeds remained perfected.

[If two security interests in the same original collateral are entitled to priority in an item of proceeds under subsection (c)(2), the security interest having priority in the original collateral has priority in the proceeds.]

Note: The bracketed language takes effect July 1, 2013.

9. **Proceeds of Non-Filing Collateral: Special Temporal Priority.** Under subsections (d) and (e), if a security interest in non-filing collateral is perfected by a method other than filing (e.g., control or possession), it does not retain its priority over a conflicting security interest in proceeds that are filing collateral. Moreover, it is not entitled to priority in proceeds under the first-to file-or-perfect rule of subsections (a)(1) and (b). Instead, under subsection (d), priority is determined by a new first-to-file rule.

Example 12: SP-1 perfects its security interest in Debtor's deposit account by obtaining control. Thereafter, SP-2 files against equipment, (presumably) searches, finds no indication of a conflicting security interest, and advances against Debtor's equipment. SP-1 then files against Debtor's equipment. Debtor uses funds from the deposit account to purchase equipment, which SP-1 can trace as proceeds of its security interest in Debtor's deposit account. If the first-to-file-or-perfect rule were applied, SP-1's security interest would be senior under subsections (a)(1) and (b), because it was the first to perfect in the original collateral and there was no period during which its security interest was unperfected. Under subsection (d), however, SP-2's security interest would be senior because it filed first. This corresponds with the likely expectations of the parties.

Note that under subsection (e), the first-to-file rule of subsection (d) applies only if the proceeds in question are other than non-filing collateral (i.e., if the proceeds are filing collateral). If the proceeds are non-filing collateral, either the first-to-file-or-perfect rule under subsections (a) and (b) or the non-temporal priority rule in

subsection (c) would apply, depending on the facts.

Example 13: SP-1 perfects its security interest in Debtor's deposit account by obtaining control. Thereafter, SP-2 files against inventory, (presumably) searches, finds no indication of a conflicting security interest, and advances against Debtor's existing and after-acquired inventory. Debtor uses funds from the deposit account to purchase inventory, which SP-1 can trace as identifiable proceeds of its security interest in Debtor's deposit account, and which SP-2 claims as original collateral. The inventory is sold and the proceeds deposited into *another* deposit account, as to which SP-1 has not obtained control. As discussed above in Comment 8, Example 11, subsection (c) does not govern priority in this deposit account. Subsection (d) also does not govern, because the proceeds at issue (the deposit account) are cash proceeds. See subsection (e). Rather, the general rules of subsections (a) and (b) govern.

10. **Priority in Supporting Obligations.** Under subsections (b)(2) and (c)(1), a security interest having priority in collateral also has priority in a supporting obligation for that collateral. However, the rules in these subsections are subject to the special rule in Section 9-329 governing the priority of security interests in a letter-of-credit right. See subsection (f). Under Section 9-329, a secured party's failure to obtain control (Section 9-107) of a letter-of-credit right that serves as supporting collateral leaves its security interest exposed to a priming interest of a party who does take control.

11. **Unperfected Security Interests.** Under subsection (a)(3), if conflicting security interests are unperfected, the first to attach has priority. This rule may be of merely theoretical interest, inasmuch as it is hard to imagine a situation where the case would come into litigation without either secured party's having perfected its security interest. If neither security interest had been perfected at the time of the filing of a petition in bankruptcy, ordinarily neither would be good against the trustee in bankruptcy under the Bankruptcy Code.

12. **Agricultural Liens.** Statutes other than this Article may purport to grant priority to an agricultural lien as against a conflicting security interest or agricultural lien. Under subsection (g), if another statute grants priority to an agricultural lien, the agricultural lien has priority only if the same statute creates the agricultural lien and the agricultural lien is perfected. Otherwise, subsection (a) applies the same priority rules to an agricultural lien as to a security interest, regardless of whether the agricultural lien conflicts with another agricultural lien or with a security interest.

Inasmuch as no agricultural lien on proceeds arises under this Article, subsections (b) through (e) do not apply to proceeds of agricultural liens. However, if an agricultural lien has priority under subsection (g) and the statute creating the agricultural lien gives the secured party a lien on proceeds of the collateral subject to the lien, a court should apply the principle of subsection (g) and award priority in the proceeds to the holder of the perfected agricultural lien.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

Annotator's note. Since § 4-9-322 is similar to § 4-9-312 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Where one's financing statement is incorrectly filed with a county clerk and recorder instead of the secretary of state, the interest of another who has properly filed his financing statement with the secretary of state has priority, even though the latter individual's statement is filed after the former's statement. Mountain Credit v. Michiana Lumber & Supply, Inc., 31 Colo. App. 112, 498 P.2d 967 (1972).

Applied in Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977); Bd. of County Comm'rs v. Berkeley Vill., 40 Colo. App. 431, 580 P.2d 1251 (1978); State Dept. of Natural Res. v. Benjamin, 41 Colo. App. 520, 587 P.2d 1207 (1978); Western Nat'l Bank v. ABC Drilling Co., 42 Colo. App. 407, 599 P.2d 942 (1979); Denver Tec Bank v. F.D.I.C., 843 P.2d 129 (Colo. App. 1992).

4-9-323. Future advances. (a) Except as otherwise provided in subsection (c) of this section, for purposes of determining the priority of a perfected security interest under section 4-9-322 (a) (1), perfection of the security interest dates from the time an advance is made to the extent that the security interest secures an advance that:

(1) Is made while the security interest is perfected only:

(A) Under section 4-9-309 when it attaches; or

(B) Temporarily under section 4-9-312 (e), (f), or (g); and

(2) Is not made pursuant to a commitment entered into before or while the security interest is perfected by a method other than under section 4-9-309 or 4-9-312 (e), (f), or (g).

(b) Except as otherwise provided in subsection (c) of this section, a security interest is subordinate to the rights of a person that becomes a lien creditor while the security interest is perfected only to the extent that the security interest secures an advance made more than forty-five days after the person becomes a lien creditor unless the advance is made:

(1) Without knowledge of the lien; or

(2) Pursuant to a commitment entered into without knowledge of the lien.

(c) Subsections (a) and (b) of this section do not apply to a security interest held by a secured party that is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor.

(d) Except as otherwise provided in subsection (e) of this section, a buyer of goods other than a buyer in ordinary course of business takes free of a security interest to the extent that it secures advances made after the earlier of:

(1) The time the secured party acquires knowledge of the buyer's purchase; or

(2) Forty-five days after the purchase.

(e) Subsection (d) of this section does not apply if the advance is made pursuant to a commitment entered into without knowledge of the buyer's purchase and before the expiration of the forty-five-day period.

(f) Except as otherwise provided in subsection (g) of this section, a lessee of goods, other than a lessee in ordinary course of business, takes the leasehold interest free of a security interest to the extent that it secures advances made after the earlier of:

(1) The time the secured party acquires knowledge of the lease; or

(2) Forty-five days after the lease contract becomes enforceable.

(g) Subsection (f) of this section does not apply if the advance is made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the forty-five-day period.

Source: L. 2001: Entire article R&RE, p. 1359, § 1, effective July 1. **L. 2002:** IP(b) amended, p. 938, § 5, effective August 7.

Editor's note: The provisions of this section are similar to provisions of several former sections as they existed prior to 2001. For a detailed comparison, see the comparative tables located in the back of the index.

OFFICIAL COMMENT

1. **Source.** Former Sections 9-312(7), 9-301(4), 9-307(3), 2A-307(4).

2. **Scope of This Section.** A security agreement may provide that collateral secures future advances. See Section 9-204(c). This section collects all of the special rules dealing with the priority of advances made by a secured party after a third party acquires an interest in the collateral. Subsection (a) applies when the third party is a competing secured party. It replaces and clarifies former Section 9-312(7). Subsection (b) deals with lien creditors and replaces former Section 9-301(4). Subsections (d) and (e) deal with buyers and replace former Section 9-307(3). Subsections (f) and (g) deal with lessees and replace former Section 2A-307(4).

3. **Competing Security Interests.** Under a proper reading of the first-to-file-or-perfect rule of Section 9-322(a)(1) (and former Section 9-312(5)), it is abundantly clear that the time when an advance is made plays no role in determining priorities among conflicting security interests except when a financing statement was not filed and the advance is the giving of value as the last step for attachment and perfection. Thus, a secured party takes subject to all advances secured by a competing security interest having priority under Section 9-322(a)(1). This result generally obtains regardless of how the competing security interest is perfected and regardless of whether the advances are made "pursuant to commitment" (Section 9-102). Subsection (a) of this section states the only other instance when the time of an advance figures in the priority scheme in Section 9-322: when the security interest is perfected only automatically under Section 9-309 or temporarily under Section 9-312(e), (f), or (g), and the advance is not made pursuant to a commitment entered into while the security interest was perfected by another method. Thus, an advance has priority from the date it is made only in the rare

case in which it is made without commitment and while the security interest is perfected only temporarily under Section 9-312.

The new formulation in subsection (a) clarifies the result when the initial advance is paid and a new ("future") advance is made subsequently. Under former Section 9-312(7), the priority of the new advance turned on whether it was "made while a security interest is perfected." This section resolves any ambiguity by omitting the quoted phrase.

Example 1: On February 1, A makes an advance secured by machinery in the debtor's possession and files a financing statement. On March 1, B makes an advance secured by the same machinery and files a financing statement. On April 1, A makes a further advance, under the original security agreement, against the same machinery. A was the first to file and so, under the first-to-file-or-perfect rule of Section 9-322(a)(1), A's security interest has priority over B's, both as to the February 1 and as to the April 1 advance. It makes no difference whether A knows of B's intervening advance when A makes the second advance. Note that, as long as A was the first to file or perfect, A would have priority with respect to both advances if either A or B had perfected by taking possession of the collateral. Likewise, A would have priority if A's April 1 advance was not made under the original agreement with the debtor, but was under a new agreement.

Example 2: On October 1, A acquires a temporarily perfected (20-day) security interest, unfiled, in a negotiable document in the debtor's possession under Section 9-312(e) or (f). The security interest secures an advance made on that day as well as future advances. On October 5, B files and thereby perfects a security interest that previously had attached to the same document. On October 8, A makes an additional advance. On October 10, A files. Under Section 9-322(a)(1), because A was the first to perfect and maintained continuous perfection or filing since the start of the 20-day period, A has priority, even after the 20-day period expires. See Section 9-322, Comment 4, Example 3. However, under this section, for purposes of Section 9-322(a)(1), to the extent A's security interest secures the October 8 advance, the security interest was perfected on October 8. Inasmuch as B perfected on October 5, B has priority over the October 8 advance.

The rule in subsection (a) is more liberal toward the priority of future advances than the corresponding rules applicable to intervening lien creditors (subsection (b)), buyers (subsections (d) and (e)), and lessees (subsections (f) and (g)).

4. **Competing Lien Creditors.** Subsection (b) replaces former Section 9-301(4), and addresses the rights of a "lien creditor," as defined in Section 9-102. Under Section 9-317(a)(2), a security interest is senior to the rights of a person who becomes a lien creditor, unless the person becomes a lien creditor before the security interest is perfected and before a financing statement covering the collateral is filed and Section 9-203(b)(3) is satisfied. Subsection (b) of this section provides that a security interest is subordinate to those rights to the extent that the specified circumstances occur. Subsection (b) does not elevate the priority of a security interest that is subordinate to the rights of a lien creditor under Section 9-317(a)(2); it only subordinates.

As under former Section 9-301(4), a secured party's knowledge does not cut short the 45-day period during which future advances can achieve priority over an intervening lien creditor's interest. Rather, because of the impact of the rule in subsection (b) on the question whether the security interest for future advances is "protected" under Section 6323(c)(2) and (d) of the Internal Revenue Code as amended by the Federal Tax Lien Act of 1966, the priority of the security interest for future advances over a lien creditor is made absolute for 45 days regardless of knowledge of the secured party concerning the lien. If, however, the advance is made after the 45 days, the advance will not have priority unless it was made or committed without knowledge of the lien.

5. **Sales of Receivables; Consignments.** Subsections (a) and (b) do not apply to outright sales of accounts, chattel paper, payment intangibles, or promissory notes, nor do they apply to consignments.

6. **Competing Buyers and Lessees.** Under subsections (d) and (e), a buyer will not take subject to a security interest to the extent it secures advances made after the secured party has knowledge that the buyer has purchased the collateral or more than 45 days after the purchase unless the advances were made pursuant to a commitment entered into before the expiration of the 45-day period and without knowledge of the purchase. Subsections (f) and (g) provide an analogous rule for lessees. Of course, a buyer in ordinary course who takes free of the security interest under Section 9-320 and a lessee in ordinary course who takes free under Section 9-321 are not subject to any future advances. Subsections (d) and (e) replace former Section 9-307(3), and subsections (f) and (g) replace former Section 2A-307(4). No change in meaning is intended.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "The Rights of Landlords in Tenants' Personal Property", see 57 Den. L.J. 685 (1980). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Agricultural Lending in a Troubled Economy", see 16 Colo. Law. 1773 (1987).

Annotator's note. Since § 4-9-323 is similar to §§ 4-9-301 and 4-9-307 as they existed prior to the 2001 repeal and reenactment of this article, relevant cases construing those provisions have been included in the annotations to this section.

Limits on purchasers taking free of security interest qualified by comment. Although this section limits the situations in which certain purchasers take free of security interests, the last paragraph under "Official Comment 2" to this section qualifies this limitation. Farmers Nat'l Bank v. Ceres Land Co., 32 Colo. App. 290, 512 P.2d 1174 (1973).

Subsection (4) was adopted to address issues relating to advances made under a perfected security interest and federal tax liens. ITT Diversified Credit Corp. v. Couch, 669 P.2d 1355 (Colo. 1983).

Applied Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977).

4-9-324. Priority of purchase-money security interests. (a) Except as otherwise provided in subsection (g) of this section, a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in section 4-9-327, a perfected security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within twenty days thereafter, or, if the collateral is a motor vehicle, as defined in section 42-6-102, C.R.S., within thirty days thereafter.

(b) Subject to subsection (c) of this section and except as otherwise provided in subsection (g) of this section, a perfected purchase-money security interest in inventory has priority over a conflicting security interest in the same inventory, has priority over a conflicting security interest in chattel paper or an instrument constituting proceeds of the inventory and in proceeds of the chattel paper, if so provided in section 4-9-330, and, except as otherwise provided in section 4-9-327, also has priority in identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer, if:

(1) The purchase-money security interest is perfected when the debtor receives possession of the inventory;

(2) The purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;

(3) The holder of the conflicting security interest receives the notification within five years before the debtor receives possession of the inventory; and

(4) The notification states that the person sending the notification has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory.

(c) Paragraphs (2) to (4) of subsection (b) of this section apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of inventory:

(1) If the purchase-money security interest is perfected by filing, before the date of the filing; or

(2) If the purchase-money security interest is temporarily perfected without filing or possession under section 4-9-312 (f), before the beginning of the twenty-day period thereunder.

(d) Subject to subsection (e) of this section and except as otherwise provided in subsection (g) of this section, a perfected purchase-money security interest in livestock that are farm products has priority over a conflicting security interest in the same livestock, and, except as otherwise provided in section 4-9-327, a perfected security interest in their identifiable proceeds and identifiable products in their unmanufactured states also has priority, if:

(1) The purchase-money security interest is perfected when the debtor receives possession of the livestock;

(2) The purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;

(3) The holder of the conflicting security interest receives the notification within six months before the debtor receives possession of the livestock; and

(4) The notification states that the person sending the notification has or expects to acquire a purchase-money security interest in livestock of the debtor and describes the livestock.

(e) Paragraphs (2) to (4) of subsection (d) of this section apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of livestock:

(1) If the purchase-money security interest is perfected by filing, before the date of the filing; or

(2) If the purchase-money security interest is temporarily perfected without filing or possession under section 4-9-312 (f), before the beginning of the twenty-day period thereunder.

(f) Except as otherwise provided in subsection (g) of this section, a perfected purchase-money security interest in software has priority over a conflicting security interest in the same collateral, and, except as otherwise provided in section 4-9-327, a perfected security interest in its identifiable proceeds also has priority, to the extent that the purchase-money security interest in the goods in which the software was acquired for use has priority in the goods and proceeds of the goods under this section.

(g) If more than one security interest qualifies for priority in the same collateral under subsection (a), (b), (d), or (f) of this section:

(1) A security interest securing an obligation incurred as all or part of the price of the collateral has priority over a security interest securing an obligation incurred for value given to enable the debtor to acquire rights in or the use of collateral; and

(2) In all other cases, section 4-9-322 (a) applies to the qualifying security interests.

Source: L. 2001: Entire article R&RE, p. 1360, § 1, effective July 1. **L. 2009:** (a) amended, (SB 09-150), ch. 182, p. 801, § 2, effective April 22.

Editor's note: This section is similar to former § 4-9-312 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-312(3), (4).

2. **Priority of Purchase-Money Security Interests.** This section contains the priority rules applicable to purchase-money security interests, as defined in Section 9-103. It affords a special, non-temporal priority to those purchase-money security interests that satisfy the statutory conditions. In most cases, priority will be over a security interest asserted under an after-acquired property clause. See Section 9-204 on the extent to which security interests in after-acquired property are validated.

A purchase-money security interest can be created only in goods and software. See Section 9-103. Section 9-324(a), which follows former Section 9-312(4), contains the general rule for purchase-money security interests in goods. It is subject to subsections (b) and (c), which derive from former Section 9-312(3) and apply to purchase-money security interests in inventory, and subsections (d) and (e), which apply to purchase-money security interests in livestock that are farm products. Subsection (f) applies to purchase-money security interests in software. Subsection (g) deals with the relatively unusual case in which a debtor creates two purchase-money security interests in the same collateral and both security interests qualify for special priority under one of the other subsections.

Former Section 9-312(2) contained a rule affording special priority to those who provided secured credit that enabled a debtor to produce crops. This rule proved unworkable and has been eliminated from this Article. Instead, model Section 9-324A contains a revised production- money priority rule. That section is a model, not uniform, provision. The sponsors of the UCC have taken no position as to whether it should be enacted, instead leaving the matter for state legislatures to consider if they are so inclined.

3. **Purchase-Money Priority in Goods Other Than Inventory and Livestock.** Subsection (a) states a general rule applicable to all

types of goods except inventory and farm-products livestock: the purchase-money interest takes priority if it is perfected when the debtor receives possession of the collateral or within 20 days thereafter. (As to the 20-day "grace period," compare Section 9-317(e). Former Sections 9-312(4) and 9-301(2) contained a 10-day grace period.) The perfection requirement means that the purchase-money secured party either has filed a financing statement before that time or has a temporarily perfected security interest in goods covered by documents under Section 9-312(e) and (f) which is continued in a perfected status by filing before the expiration of the 20-day period specified in that section. A purchase-money security interest qualifies for priority under subsection (a), even if the purchase-money secured party knows that a conflicting security interest has been created and/or that the holder of the conflicting interest has filed a financing statement covering the collateral.

Normally, there will be no question when "the debtor receives possession of the collateral" for purposes of subsection (a). However, sometimes a debtor buys goods and takes possession of them in stages, and then assembly and testing are completed (by the seller or debtor-buyer) at the debtor's location. Under those circumstances, the buyer "takes possession" within the meaning of subsection (a) when, after an inspection of the portion of the goods in the debtor's possession, it would be apparent to a potential lender to the debtor that the debtor has acquired an interest in the goods taken as a whole.

A similar issue concerning the time when "the debtor receives possession" arises when a person acquires possession of goods under a transaction that is not governed by this Article and then later agrees to buy the goods on secured credit. For example, a person may take possession of goods as lessee under a lease contract and then exercise an option to purchase the goods from the lessor on secured credit. Under Section 2A-307(1), creditors of the lessee generally take subject to the lease contract; filing a financing statement against the lessee is unnecessary to protect the lessor's leasehold or residual interest. Once the lease is converted to a security interest, filing a financing statement is necessary to protect the seller's (former lessor's) security interest. Accordingly, the 20-day period in subsection (a) does not commence until the goods become "collateral" (defined in Section 9-102), i.e., until they are subject to a security interest.

4. **Purchase-Money Security Interests in Inventory.** Subsections (b) and (c) afford a means by which a purchase-money security interest in inventory can achieve priority over an earlier-filed security interest in the same collateral. To achieve priority, the purchase-money security interest must be perfected when the debtor receives possession of the inventory. For a discussion of when "the debtor receives possession," see Comment 3, above. The 20-day grace period of subsection (a) does not apply.

The arrangement between an inventory secured party and its debtor typically requires the secured party to make periodic advances against incoming inventory or periodic releases of old inventory as new inventory is received. A fraudulent debtor may apply to the secured party for advances even though it has already given a purchase-money security interest in the inventory to another secured party. For this reason, subsections (b)(2) through (4) and (c) impose a second condition for the purchase-money security interest's achieving priority: the purchase-money secured party must give notification to the holder of a conflicting security interest who filed against the same item or type of inventory before the purchase-money secured party filed or its security interest became perfected temporarily under Section 9-312(e) or (f). The notification requirement protects the non-purchase-money inventory secured party in such a situation: if the inventory secured party has received notification, it presumably will not make an advance; if it has not received notification (or if the other security interest does not qualify as purchase-money), any advance the inventory secured party may make ordinarily will have priority under Section 9-322. Inasmuch as an arrangement for periodic advances against incoming goods is unusual outside the inventory field, subsection (a) does not contain a notification requirement.

5. **Notification to Conflicting Inventory Secured Party: Timing.** Under subsection (b)(3), the perfected purchase-money security interest achieves priority over a conflicting security interest only if the holder of the conflicting security interest receives a notification within five years before the debtor receives possession of the purchase-money collateral. If the debtor never receives possession, the five-year period never begins, and the purchase-money security interest has priority, even if notification is not given. However, where the purchase-money inventory financing began by the purchase-money secured party's possession of a negotiable document of title, to retain priority the secured party must give the notification required by subsection (b) at or before the usual time, i.e., when the debtor gets possession of the inventory, even though the security interest remains perfected for 20 days under Section 9-312(e) or (f).

Some people have mistakenly read former Section 9-312(3)(b) to require, as a condition of purchase-money priority in inventory, that the purchase-money secured party give the notification before it files a financing statement. Read correctly, the "before" clauses compare (i) the time when the holder of the conflicting security

interest filed a financing statement with (ii) the time when the purchase-money security interest becomes perfected by filing or automatically perfected temporarily. Only if (i) occurs before (ii) must notification be given to the holder of the conflicting security interest. Subsection (c) has been rewritten to clarify this point.

6. **Notification to Conflicting Inventory Secured Party: Address.** Inasmuch as the address provided as that of the secured party on a filed financing statement is an "address that is reasonable under the circumstances," the holder of a purchase-money security interest may satisfy the requirement to "send" notification to the holder of a conflicting security interest in inventory by sending a notification to that address, even if the address is or becomes incorrect. See Section 9-102 (definition of "send"). Similarly, because the address is "held out by [the holder of the conflicting security interest] as the place for receipt of such communications [i.e., communications relating to security interests]," the holder is deemed to have "received" a notification delivered to that address. See Section 1-201(26).

Note: "1-201(26)." will be replaced with "1-202(e)." effective July 1, 2013.

7. **Consignments.** Subsections (b) and (c) also determine the priority of a consignor's interest in consigned goods as against a security interest in the goods created by the consignee. Inasmuch as a consignment subject to this Article is defined to be a purchase-money security interest, see Section 9-103(d), no inference concerning the nature of the transaction should be drawn from the fact that a consignor uses the term "security interest" in its notice under subsection (b)(4). Similarly, a notice stating that the consignor has delivered or expects to deliver goods, properly described, "on consignment" meets the requirements of subsection (b)(4), even if it does not contain the term "security interest," and even if the transaction subsequently is determined to be a security interest. Cf. Section 9-505 (use of "consignor" and "consignee" in financing statement).

8. **Priority in Proceeds: General.** When the purchase-money secured party has priority over another secured party, the question arises whether this priority extends to the proceeds of the original collateral. Subsections (a), (d), and (f) give an affirmative answer, but only as to proceeds in which the security interest is perfected (see Section 9-315). Although this qualification did not appear in former Section 9-312(4), it was implicit in that provision.

In the case of inventory collateral under subsection (b), where financing frequently is based on the resulting accounts, chattel paper, or other proceeds, the special priority of the purchase-money secured interest carries over into only certain types of proceeds. As under former Section 9-312(3), the purchase-money priority in inventory under subsection (b) carries over into identifiable cash proceeds (defined in Section 9-102) received on or before the delivery of the inventory to a buyer.

As a general matter, also like former Section 9-312(3), the purchase-money priority in inventory does *not* carry over into proceeds consisting of accounts or chattel paper. Many parties financing inventory are quite content to protect their first-priority security interest in the inventory itself. They realize that when the inventory is sold, someone else will be financing the resulting receivables (accounts or chattel paper), and the priority for inventory will not run forward to the receivables constituting the proceeds. Indeed, the cash supplied by the receivables financer often will be used to pay the inventory financing. In some situations, the party financing the inventory on a purchase-money basis makes contractual arrangements that the proceeds of receivables financing by another be devoted to paying off the inventory security interest.

However, the purchase-money priority in inventory does carry over to proceeds consisting of chattel paper and its proceeds (and also to instruments) to the extent provided in Section 9-330. Under Section 9-330(e), the holder of a purchase-money security interest in inventory is deemed to give new value for proceeds consisting of chattel paper. Taken together, Sections 9-324(b) and 9-330(e) enable a purchase-money inventory secured party to obtain priority in chattel paper constituting proceeds of the inventory, even if the secured party does not actually give new value for the chattel paper, provided the purchase-money secured party satisfies the other conditions for achieving priority.

When the proceeds of original collateral (goods or software) consist of a deposit account, Section 9-327 governs priority to the extent it conflicts with the priority rules of this section.

9. **Priority in Accounts Constituting Proceeds of Inventory.** The application of the priority rules in subsection (b) is shown by the following examples:

Example 1: Debtor creates a security interest in its existing and after-acquired inventory in favor of SP-1, who files a financing statement covering inventory. SP-2 subsequently takes a purchase-money security interest in certain inventory and, under subsection (b), achieves priority in this inventory over SP-1. This inventory is then sold, producing accounts. Accounts are not cash proceeds, and so the special purchase-money priority in the inventory does not control the priority in the accounts. Rather, the first-to-file-or-perfect rule of Section 9-322(a)(1) applies. The time of SP-1's filing as to the inventory is also the time of filing as to the accounts under Section 9-322 (b). Assuming that each security interest in the accounts proceeds re-

mains perfected under Section 9-315, SP-1 has priority as to the accounts.

Example 2: In Example 1, if SP-2 had filed directly against accounts, the date of that filing as to accounts would be compared with the date of SP-1's filing as to the inventory. The first filed would prevail under Section 9-322(a)(1).

Example 3: If SP-3 had filed against accounts in Example 1 before either SP-1 or SP-2 filed against inventory, SP-3's filing against accounts would have priority over the filings of SP-1 and SP-2. This result obtains even though the filings against inventory are effective to continue the perfected status of SP-1's and SP-2's security interest in the accounts beyond the 20-day period of automatic perfection. See Section 9-315. SP-1's and SP-2's position as to the inventory does not give them a claim to accounts (as proceeds of the inventory) which is senior to someone who has filed earlier against accounts. If, on the other hand, either SP-1's or SP-2's filing against the inventory preceded SP-3's filing against accounts, SP-1 or SP-2 would outrank SP-3 as to the accounts.

10. **Purchase-Money Security Interests in Livestock.** New subsections (d) and (e) provide a purchase-money priority rule for farm-products livestock. They are patterned on the purchase-money priority rule for inventory found in subsections (b) and (c) and include a requirement that the purchase-money secured party notify earlier-filed parties. Two differences between subsections (b) and (d) are noteworthy. First, unlike the purchase-money inventory lender, the purchase-money livestock lender enjoys priority in *all* proceeds of the collateral. Thus, under subsection (d), the purchase-money secured party takes priority in accounts over an earlier-filed accounts financer. Second, subsection (d) affords priority in certain products of the collateral as well as proceeds.

11. **Purchase-Money Security Interests in Aquatic Farm Products.** Aquatic goods produced in aquacultural operations (e.g., catfish raised on a catfish farm) are farm products. See Section 9-102 (definition of "farm products"). The definition does not indicate whether aquatic goods are "crops," as to which the model production money security interest priority in Section 9- 324A applies, or "livestock," as to which the purchase-money priority in subsection (d) of this section applies. This Article leaves courts free to determine the classification of particular aquatic goods on a case-by-case basis, applying whichever priority rule makes more sense in the overall context of the debtor's business.

12. **Purchase-Money Security Interests in Software.** Subsection (f) governs the priority of purchase-money security interests in software. Under Section 9-103(c), a purchase-money security interest arises in software only if the debtor acquires its interest in the software for the principal purpose of using the software in goods subject to a purchase-money security interest. Under subsection (f), a purchase-money security interest in software has the same priority as the purchase-money security interest in the goods in which the software was acquired for use. This priority is determined under subsections (b) and (c) (for inventory) or (a) (for other goods).

13. **Multiple Purchase-Money Security Interests.** New subsection (g) governs priority among multiple purchase-money security interests in the same collateral. It grants priority to purchase-money security interests securing the price of collateral (i.e., created in favor of the seller) over purchase-money security interests that secure enabling loans. Section 7.2(c) of the Restatement (3d) of the Law of Property (Mortgages) (1997) adopts this rule with respect to real property mortgages. As Comment *d* to that section explains:

The equities favor the vendor. Not only does the vendor part with specific real estate rather than money, but the vendor would never relinquish it at all except on the understanding that the vendor will be able to use it to satisfy the obligation to pay the price. This is the case even though the vendor may know that the mortgagor is going to finance the transaction in part by borrowing from a third party and giving a mortgage to secure that obligation. In the final analysis, the law is more sympathetic to the vendor's hazard of losing real estate previously owned than to the third party lender's risk of being unable to collect from an interest in real estate that never previously belonged to it.

The first-to-file-or-perfect rule of Section 9-322 applies to multiple purchase-money security interests securing enabling loans.

4-9-325. Priority of security interests in transferred collateral. (a) Except as otherwise provided in subsection (b) of this section, a security interest created by a debtor is subordinate to a security interest in the same collateral created by another person if:

(1) The debtor acquired the collateral subject to the security interest created by the other person;

(2) The security interest created by the other person was perfected when the debtor acquired the collateral; and

(3) There is no period thereafter when the security interest is unperfected.

(b) Subsection (a) of this section subordinates a security interest only if the security interest:

(1) Otherwise would have priority solely under section 4-9-322 (a) or 4-9-324; or
(2) Arose solely under section 4-2-711 (3) or 4-2.5-508 (5).

Source: L. 2001: Entire article R&RE, p. 1362, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **"Double Debtor Problem."** This section addresses the "double debtor" problem, which arises when a debtor acquires property that is subject to a security interest created by another debtor.

3. **Taking Subject to Perfected Security Interest.** Consider the following scenario:

Example 1: A owns an item of equipment subject to a perfected security interest in favor of SP-A. A sells the equipment to B, not in the ordinary course of business. B acquires its interest subject to SP-A's security interest. See Sections 9-201, 9-315(a)(1). Under this section, if B creates a security interest in the equipment in favor of SP-B, SP-B's security interest is subordinate to SP-A's security interest, even if SP-B filed against B before SP-A filed against A, and even if SP-B took a purchase-money security interest. Normally, SP-B could have investigated the source of the equipment and discovered SP-A's filing before making an advance against the equipment, whereas SP-A had no reason to search the filings against someone other than its debtor, A.

4. **Taking Subject to Unperfected Security Interest.** This section applies only if the security interest in the transferred collateral was perfected when the transferee acquired the collateral. See subsection (a)(2). If this condition is not met, then the normal priority rules apply.

Example 2: A owns an item of equipment subject to an unperfected security interest in favor of SP-A. A sells the equipment to B, who gives value and takes delivery of the equipment without knowledge of the security interest. B takes free of the security interest. See Section 9-317(b). If B then creates a security interest in favor of SP-B, no priority issue arises; SP-B has the only security interest in the equipment.

Example 3: The facts are as in Example 2, except that B knows of SP-A's security interest and therefore takes the equipment subject to it. If B creates a security interest in the equipment in favor of SP-B, this section does not determine the relative priority of the security interests. Rather, the normal priority rules govern. If SP-B perfects its security interest, then, under Section 9-322(a)(2), SP-A's unperfected security interest will be junior to SP-B's perfected security interest. The award of priority to SP-B is premised on the belief that SP-A's failure to file could have misled SP-B.

5. **Taking Subject to Perfected Security Interest that Becomes Unperfected.** This section applies only if the security interest in the transferred collateral did not become unperfected at any time after the transferee acquired the collateral. See subsection (a)(3). If this condition is not met, then the normal priority rules apply.

Example 4: As in Example 1, A owns an item of equipment subject to a perfected security interest in favor of SP-A. A sells the equipment to B, not in the ordinary course of business. B acquires its interest subject to SP-A's security interest. See Sections 9-201, 9-315(a)(1). B creates a security interest in favor of SP-B, and SP-B perfects its security interest. This section provides that SP-A's security interest is senior to SP-B's. However, if SP-A's financing statement lapses while SP-B's security interest is perfected, then the normal priority rules would apply, and SP-B's security interest would become senior to SP-A's security interest. See Sections 9-322(a)(2), 9-515(c).

6. **Unusual Situations.** The appropriateness of the rule of subsection (a) is most apparent when it works to subordinate security interests having priority under the basic priority rules of Section 9-322(a) or the purchase-money priority rules of Section 9-324. The rule also works properly when applied to the security interest of a buyer under Section 2-711(3) or a lessee under Section 2A-508(5). However, subsection (a) may provide an inappropriate resolution of the "double debtor" problem in some of the wide variety of other contexts in which the problem may arise. Although subsection (b) limits the application of subsection (a) to those cases in which subordination is known to be appropriate, courts should apply the rule in other settings, if necessary to promote the underlying purposes and policies of the Uniform Commercial Code. See Section 1-102(1).

4-9-326. Priority of security interests created by new debtor. (a) Subject to subsection (b) of this section, a security interest created by a new debtor which is perfected by a filed financing statement that is effective solely under section 4-9-508 in collateral in which a new debtor has or acquires rights is subordinate to a security interest in the same collateral which is perfected other than by a filed financing statement that is effective solely under section 4-9-508.

(b) The other provisions of this part 3 determine the priority among conflicting security interests in the same collateral perfected by filed financing statements that are effective solely under section 4-9-508. However, if the security agreements to which a new debtor became bound as debtor were not entered into by the same original debtor, the conflicting security interests rank according to priority in time of the new debtor's having become bound.

Editor's note: This version of this section is effective until July 1, 2013.

4-9-326. Priority of security interests created by new debtor. (a) Subject to subsection (b) of this section, a security interest that is created by a new debtor in collateral in which the new debtor has or acquires rights and is perfected solely by a filed financing statement that would be ineffective to perfect the security interest but for the application of section 4-9-316 (i) (1) or 4-9-508 is subordinate to a security interest in the same collateral that is perfected other than by such a filed financing statement.

(b) The other provisions of this part 3 determine the priority among conflicting security interests in the same collateral perfected by filed financing statements described in subsection (a) of this section. However, if the security agreements to which a new debtor became bound as debtor were not entered into by the same original debtor, the conflicting security interests rank according to priority in time of the new debtor's having become bound.

Editor's note: This version of this section is effective July 1, 2013.

Source: L. 2001: Entire article R&RE, p. 1362, § 1, effective July 1. **L. 2012:** Entire section amended, (HB 12-1262), ch. 170, p. 599, § 7, effective July 1, 2013.

OFFICIAL COMMENT

1. **Source.** New.

2. **Subordination of Security Interests Created by New Debtor.** This section addresses the priority contests that may arise when a new debtor becomes bound by the security agreement of an original debtor and each debtor has a secured creditor.

Subsection (a) subordinates the original debtor's secured party's security interest perfected against the new debtor solely under Section 9-508. The security interest is subordinated to security interests in the same collateral perfected by another method, e.g., by filing against the new debtor. As used in this section, "a filed financing statement that is effective solely under Section 9-508" refers to a financing statement filed against the *original debtor* that continues to be effective under Section 9-508. It does not encompass a new initial financing statement providing the name of the new debtor, even if the initial financing statement is filed to maintain the effectiveness of a financing statement under the circumstances described in Section 9-508(b). Nor does it encompass a financing statement filed against the original debtor which remains effective against collateral transferred by the original debtor to the new debtor. See Section 9-508(c). Concerning priority contests involving transferred collateral, see Sections 9-325 and 9-507.

Example 1: SP-X holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory, and SP-Z holds a perfected-by-possession security interest in an item of Z Corp's inventory. Z Corp becomes bound as debtor by X Corp's security agreement (e.g., Z Corp buys X Corp's assets and assumes its security agreement). See Section 9-203(d). Under Section 9-508, SP-X's financing statement is effective to perfect a security interest in the item of inventory in which Z Corp has rights. However, subsection (a) provides that SP-X's security interest is subordinate to SP-Z's, regardless of whether SP-X's financing statement was filed before SP-Z perfected its security interest.

Example 2: SP-X holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory, and SP-Z holds a perfected-by-filing security interest in Z Corp's existing and after-acquired inventory. Z Corp becomes bound as debtor by X Corp's security agreement. Subsequently, Z Corp acquires a new item of inventory. Under Section 9-508, SP-X's financing statement is effective to perfect a security interest in the new item of inventory in which Z Corp has rights. However, because SP-Z's security interest was perfected by another method, subsection (a) provides that SP-X's security interest is subordinate to SP-Z's, regardless of which financing statement was filed first. This would be the case even if SP-Z filed after Z Corp became bound by X Corp's security agreement.

Note: This version of paragraph 2. is effective until July 1, 2013.

2. **Subordination of Security Interests Created by New Debtor.** This section addresses the priority contests that may arise when a new debtor becomes bound by the security agreement of an original debtor and each debtor has a secured creditor.

Subsection (a) subordinates the original debtor's secured party's security interest perfected against the new debtor by a filed financing statement that would be ineffective to perfect the security interest but for Section 9-508 or, if the original debtor and new debtor are located in different jurisdictions, Section 9-316(i)(1). The security interest is subordinated to security interests in the same collateral perfected by another method, e.g., by filing against the new debtor. This section does not subordinate a security interest perfected by a new initial financing statement providing the name of the new debtor, even if the initial financing statement is filed to maintain the effectiveness of a financing statement under the circumstances described in Section 9-508(b). Nor does it subordinate a security interest perfected by a financing statement filed against the original debtor which remains effective against collateral transferred by the original debtor to the new debtor. See Section 9-508(c). Concerning priority contests involving transferred collateral, see Sections 9-325 and 9-507.

Example 1: SP-X holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory, and SP-Z holds a perfected-by-possession security interest in an item of Z Corp's inventory. Both X Corp and Z Corp are located in the same jurisdiction under Section 9-307. Z Corp becomes bound as debtor by X Corp's security agreement (e.g., Z Corp buys X Corp's assets and assumes its security agreement). See Section 9-203(d). But for Section 9-508, SP-X's financing statement would be ineffective to perfect a security interest in the item of inventory in which Z Corp has rights. However, subsection (a) provides that SP-X's perfected security interest is subordinate to SP-Z's, regardless of whether SP-X's financing statement was filed before SP-Z perfected its security interest.

Example 2: SP-X holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory, and SP-Z holds a perfected-by-filing security interest in Z Corp's existing and after-acquired inventory. Both X Corp and Z Corp are located in the same jurisdiction under Section 9-307. Z Corp becomes bound as debtor by X Corp's security agreement. Immediately thereafter, and before the effectiveness of SP-X's financing statement lapses, Z Corp acquires a new item of inventory. But for Section 9-508, SP-X's financing statement would be ineffective to perfect a security interest in the new item of inventory in which Z Corp has rights. However, because SP-Z's security interest was perfected by a filing whose effectiveness does not depend on Section 9-316(i)(1) or 9-508, subsection (a) subordinates SP-X's perfected security interest to SP-Z's. This would be the case even if SP-Z filed after Z Corp became bound by X Corp's security agreement, and regardless of which financing statement was filed first.

The same result would obtain if X Corp and Z Corp were located in different jurisdictions. SP-X's security interest would be perfected by a financing statement that would be ineffective but for Section 9-316(i)(1), whereas the effectiveness of SP-Z's filing does not depend on Section 9-316(i)(1) or 9-508.

Note: This version of paragraph 2. is effective July 1, 2013.

3. **Other Priority Rules.** Subsection (b) addresses the priority among security interests created by the original debtor (X Corp). By invoking the other priority rules of this subpart, as applicable, subsection (b) preserves the relative priority of security interests created by the original debtor.

Example 3: Under the facts of Example 2, SP-Y also holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory. SP-Y filed after SP-X. Inasmuch as both SP-X's and SP-Y's security interests in inventory acquired by Z Corp after it became bound are perfected solely under Section 9-508, the normal priority rules determine their relative priorities. Under the "first-to-file-or-perfect" rule of Section 9-322(a)(1), SP-X has priority over SP-Y.

Note: This version of example 3 is effective until July 1, 2013.

Example 3: Under the facts of Example 2, SP-Y also holds a perfected-by-filing security interest in X Corp's existing and after-acquired inventory. SP-Y filed after SP-X. Inasmuch as both SP-X's and SP-Y's security interests in inventory acquired by Z Corp after it became bound would be unperfected but for the application of Section 9-508, the normal priority rules determine their relative priorities. Under the "first-to-file-or-perfect" rule of Section 9-322(a)(1), SP-X has priority over SP-Y.

Note: This version of example 3 is effective July 1, 2013.

Example 4: Under the facts of Example 3, after Z Corp became bound by X Corp's security agreement, SP-Y promptly filed a new initial financing statement against Z Corp. At that time, SP-X's security interest was perfected only by virtue of its original filing against X Corp which was "effective solely under Section 9-508." Because SP-Y's security interest no longer is perfected by a financing statement that is "effective solely under Section 9-508," this section does not apply to the priority contest. Rather, the normal priority rules apply. Under

Section 9-322, because SP-Y's financing statement was filed *against Z Corp*, the new debtor, before SP-X's, SP-Y's security interest is senior to that of SP-X. Similarly, the normal priority rules would govern priority between SP-Y and SP-Z.

Note: This version of example 4 is effective until July 1, 2013.

Example 4: Under the facts of Example 3, after Z Corp became bound by X Corp's security agreement, SP-Y promptly filed a new initial financing statement against Z Corp. SP-X's security interest remains perfected only by virtue of its original filing against X Corp which "would be ineffective to perfect the security interest but for the application of Section 9-508." Because SP-Y's security interest is perfected by the filing of a financing statement whose effectiveness does not depend on Section 9-508 or 9-316(i)(1), subsection (a) subordinates SP-X's security interest to SP-Y's. If both SP-X and SP-Y file a new initial financing statement against Z Corp, then the "first-to-file-or-perfect" rule of Section 9-322(a)(1) governs their priority inter se as well as their priority against SP-Z.

Note: This version of example 4 is effective July 1, 2013.

The second sentence of subsection (b) effectively limits the applicability of the first sentence to situations in which a new debtor has become bound by more than one security agreement entered into by the *same* original debtor. When the new debtor has become bound by security agreements entered into by *different* original debtors, the second sentence provides that priority is based on priority in time of the new debtor's becoming bound.

Example 5: Under the facts of Example 2, SP-W holds a perfected-by-filing security interest in W Corp's existing and after-acquired inventory. After Z Corp became bound by X Corp's security agreement in favor of SP-X, Z Corp became bound by W Corp's security agreement. Under subsection (b), SP-W's security interest in inventory acquired by Z Corp is subordinate to that of SP-X, because Z Corp became bound under SP-X's security agreement before it became bound under SP-W's security agreement. This is the result regardless of which financing statement (SP-X's or SP-W's) was filed first.

The second sentence of subsection (b) reflects the generally accepted view that priority based on the first-to-file rule is inappropriate for resolving priority disputes when the filings were made against different debtors. Like subsection (a) and the first sentence of subsection (b), however, the second sentence of subsection (b) relates only to priority conflicts among security interests perfected by filed financing statements that are "effective solely under Section 9-508."

Note: This version of this paragraph is effective until July 1, 2013.

The second sentence of subsection (b) reflects the generally accepted view that priority based on the first-to-file rule is inappropriate for resolving priority disputes when the filings were made against different debtors. Like subsection (a) and the first sentence of subsection (b), however, the second sentence of subsection (b) relates only to priority conflicts among security interests that would be unperfected but for the application of Section 9-316(i)(1) or 9-508.

Note: This version of this paragraph is effective July 1, 2013.

Example 6: Under the facts of Example 5, after Z Corp became bound by W Corp's security agreement, SP-W promptly filed a new initial financing statement against Z Corp. At that time, SP-X's security interest was perfected only pursuant to its original filing against X Corp which was "effective solely under Section 9-508." Because SP-W's security interest is not perfected by a financing statement that is "effective solely under Section 9-508," this section does not apply to the priority contest. Rather, the normal priority rules apply. Under Section 9-322, because SP-W's financing statement was the first to be filed *against Z Corp*, the new debtor, SP-W's security interest is senior to that of SP-X. Similarly, the normal priority rules would govern priority between SP-W and SP-Z.

Note: This version of example 6 is effective until July 1, 2013.

Example 6: Under the facts of Example 5, after Z Corp became bound by W Corp's security agreement, SP-W promptly filed a new initial financing statement against Z Corp. At that time, SP-X's security interest was perfected only pursuant to its original filing against X Corp which "would be ineffective to perfect the security interest but for the application of Section 9-508." Because SP-W's security interest is perfected by the filing of a financing statement whose effectiveness does not depend on Section 9-316(i)(1) or 9-508, subsection (a) subordinates SP-X's security interest to SP-W's. If both SP-X and SP-W file a new initial financing statement against Z Corp, then the "first-to-file-or-perfect" rule of Section 9-322(a)(1) governs their priority inter se as well as their priority against SP-Z.

Note: This version of example 6 takes effect July 1, 2013.

4-9-327. Priority of security interests in deposit account. The following rules govern priority among conflicting security interests in the same deposit account:

(1) A security interest held by a secured party having control of the deposit account under section 4-9-104 has priority over a conflicting security interest held by a secured party that does not have control.

(2) Except as otherwise provided in paragraphs (3) and (4) of this section, security interests perfected by control under section 4-9-314 rank according to priority in time of obtaining control.

(3) Except as otherwise provided in paragraph (4) of this section, a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.

(4) A security interest perfected by control under section 4-9-104 (a) (3) has priority over a security interest held by the bank with which the deposit account is maintained.

Source: L. 2001: Entire article R&RE, p. 1363, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New; derived from former Section 9-115(5).

2. **Scope of This Section.** This section contains the rules governing the priority of conflicting security interests in deposit accounts. It overrides conflicting priority rules. See Sections 9-322(f)(1), 9-324(a), (b), (d), (f). This section does not apply to accounts evidenced by an instrument (e.g., certain certificates of deposit), which by definition are not "deposit accounts."

3. **Control.** Under paragraph (1), security interests perfected by control (Sections 9-314, 9-104) take priority over those perfected otherwise, e.g., as identifiable cash proceeds under Section 9-315. Secured parties for whom the deposit account is an integral part of the credit decision will, at a minimum, insist upon the right to immediate access to the deposit account upon the debtor's default (i.e., control). Those secured parties for whom the deposit account is less essential will not take control, thereby running the risk that the debtor will dispose of funds on deposit (either outright or for collateral purposes) after default but before the account can be frozen by court order or the secured party can obtain control.

Paragraph (2) governs the case (expected to be very rare) in which a bank enters into a Section 9-104(a)(2) control agreement with more than one secured party. It provides that the security interests rank according to time of obtaining control. If the bank is solvent and the control agreements are well drafted, the bank will be liable to each secured party, and the priority rule will have no practical effect.

4. **Priority of Bank.** Under paragraph (3), the security interest of the bank with which the deposit account is maintained normally takes priority over all other conflicting security interests in the deposit account, regardless of whether the deposit account constitutes the competing secured party's original collateral or its proceeds. A rule of this kind enables banks to extend credit to their depositors without the need to examine either the public record or their own records to determine whether another party might have a security interest in the deposit account.

A secured party who takes a security interest in the deposit account as original collateral can protect itself against the results of this rule in one of two ways. It can take control of the deposit account by becoming the bank's customer. Under paragraph (4), this arrangement operates to subordinate the bank's security interest. Alternatively, the secured party can obtain a subordination agreement from the bank. See Section 9-339.

A secured party who claims the deposit account as proceeds of other collateral can reduce the risk of becoming junior by obtaining the debtor's agreement to deposit proceeds into a specific cash-collateral account and obtaining the agreement of that bank to subordinate all its claims to those of the secured party. But if the debtor violates its agreement and deposits funds into a deposit account other than the cash-collateral account, the secured party risks being subordinated.

5. **Priority in Proceeds of, and Funds Transferred from, Deposit Account.** The priority afforded by this section does not extend to proceeds of a deposit account. Rather, Section 9-322(c) through (e) and the provisions referred to in Section 9-322(f) govern priorities in proceeds of a deposit account. Section 9-315(d) addresses continuation of perfection in proceeds of deposit accounts. As to funds transferred from a deposit account that serves as collateral, see Section 9-332.

4-9-328. Priority of security interests in investment property. The following rules govern priority among conflicting security interests in the same investment property:

(1) A security interest held by a secured party having control of investment property under section 4-9-106 has priority over a security interest held by a secured party that does not have control of the investment property.

(2) Except as otherwise provided in paragraphs (3) and (4) of this section, conflicting security interests held by secured parties each of which has control under section 4-9-106 rank according to priority in time of:

(A) If the collateral is a security, obtaining control;

(B) If the collateral is a security entitlement carried in a securities account and:

(i) If the secured party obtained control under section 4-8-106 (d) (1), the secured party's becoming the person for which the securities account is maintained;

(ii) If the secured party obtained control under section 4-8-106 (d) (2), the securities intermediary's agreement to comply with the secured party's entitlement orders with respect to security entitlements carried or to be carried in the securities account; or

(iii) If the secured party obtained control through another person under section 4-8-106 (d) (3), the time on which priority would be based under this paragraph (2) if the other person were the secured party; or

(C) If the collateral is a commodity contract carried with a commodity intermediary, the satisfaction of the requirement for control specified in section 4-9-106 (b) (2) with respect to commodity contracts carried or to be carried with the commodity intermediary.

(3) A security interest held by a securities intermediary in a security entitlement or a securities account maintained with the securities intermediary has priority over a conflicting security interest held by another secured party.

(4) A security interest held by a commodity intermediary in a commodity contract or a commodity account maintained with the commodity intermediary has priority over a conflicting security interest held by another secured party.

(5) A security interest in a certificated security in registered form which is perfected by taking delivery under section 4-9-313 (a) and not by control under section 4-9-314 has priority over a conflicting security interest perfected by a method other than control.

(6) Conflicting security interests created by a broker, securities intermediary, or commodity intermediary which are perfected without control under section 4-9-106 rank equally.

(7) In all other cases, priority among conflicting security interests in investment property is governed by sections 4-9-322 and 4-9-323.

Source: L. 2001: Entire article R&RE, p. 1363, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-115 (5) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-115(5).

2. **Scope of This Section.** This section contains the rules governing the priority of conflicting security interests in investment property. Paragraph (1) states the most important general rule that a secured party who obtains control has priority over a secured party who does not obtain control. Paragraphs (2) through (4) deal with conflicting security interests each of which is perfected by control. Paragraph (5) addresses the priority of a security interest in a certificated security which is perfected by delivery but not control. Paragraph (6) deals with the relatively unusual circumstance in which a broker, securities intermediary, or commodity intermediary has created conflicting security interests none of which is perfected by control. Paragraph (7) provides that the general priority rules of Sections 9-322 and 9-323 apply to cases not covered by the specific rules in this section. The principal application of this residual rule is that the usual first in time of filing rule applies to conflicting security interests that are perfected only by filing. Because the control priority rule of paragraph (1) provides for the ordinary cases in which persons purchase securities on margin credit from their brokers, there is no need for special rules for purchase-money security interests. See also Section 9-103 (limiting purchase-money collateral to goods and software).

3. **General Rule: Priority of Security Interest Perfected by Control.** Under paragraph

(1), a secured party who obtains control has priority over a secured party who does not obtain control. The control priority rule does not turn on either temporal sequence or awareness of conflicting security interests. Rather, it is a structural rule, based on the principle that a lender should be able to rely on the collateral without question if the lender has taken the necessary steps to assure itself that it is in a position where it can foreclose on the collateral without further action by the debtor. The control priority rule is necessary because the perfection rules provide considerable flexibility in structuring secured financing arrangements. For example, at the "retail" level, a secured lender to an investor who wants the full measure of protection can obtain control, but the creditor may be willing to accept the greater measure of risk that follows from perfection by filing. Similarly, at the "wholesale" level, a lender to securities firms can leave the collateral with the debtor and obtain a perfected security interest under the automatic perfection rule of Section 9-309(10), but a lender who wants to be entirely sure of its position will want to obtain control. The control priority rule of paragraph (1) is an essential part of this system of flexibility. It is feasible to provide more than one method of perfecting security interests only if the rules ensure that those who take the necessary steps to obtain the full measure of protection do not run the risk of subordination to those who have not taken such steps. A secured party who is unwilling to run the risk that the debtor has granted or will grant a conflicting control security interest should not make a loan without obtaining control of the collateral.

As applied to the retail level, the control priority rule means that a secured party who obtains control has priority over a conflicting security interest perfected by filing without regard to inquiry into whether the control secured party was aware of the filed security interest. Prior to the 1994 revisions to Articles 8 and 9, Article 9 did not permit perfection of security interests in securities by filing. Accordingly, parties who deal in securities never developed a practice of searching the UCC files before conducting securities transactions. Although filing is now a permissible method of perfection, in order to avoid disruption of existing practices in this business it is necessary to give perfection by filing a different and more limited effect for securities than for some other forms of collateral. The priority rules are not based on the assumption that parties who perfect by the usual method of obtaining control will search the files. Quite the contrary, the control priority rule is intended to ensure that, with respect to investment property, secured parties who do obtain control are entirely unaffected by filings. To state the point another way, perfection by filing is intended to affect only general creditors or other secured creditors who rely on filing. The rule that a security interest perfected by filing can be primed by a control security interest, without regard to awareness, is a consequence of the system of perfection and priority rules for investment property. These rules are designed to take account of the circumstances of the securities markets, where filing is not given the same effect as for some other forms of property. No implication is made about the effect of filing with respect to security interests in other forms of property, nor about other Article 9 rules, e.g., Section 9-330, which govern the circumstances in which security interests in other forms of property perfected by filing can be primed by subsequent perfected security interests.

The following examples illustrate the application of the priority rule in paragraph (1):

Example 1: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock for which Debtor has a certificate. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor delivers the certificate, properly indorsed, to Beta. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(b)(1), and hence has priority over Alpha.

Example 2: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, held through a securities account with Able & Co. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor instructs Able to have the 1000 shares transferred through the clearing corporation to Custodian Bank, to be credited to Beta's account with Custodian Bank. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(d)(1), and hence has priority over Alpha.

Example 3: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, which is held through a securities account with Able & Co. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Alpha and Beta both have perfected security interests in the XYZ Co. stock (more precisely, in the Debtor's security entitlement to the financial

asset consisting of the XYZ Co. stock). Beta has control, see Section 8-106(d)(2), and hence has priority over Alpha.

Example 4: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, held through a securities account with Able & Co. Alpha perfects by filing. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor incurs obligations to Able and later defaults on the obligations to Alpha and Able. Able has control by virtue of the rule of Section 8-106(e) that if a customer grants a security interest to its own intermediary, the intermediary has control. Since Alpha does not have control, Able has priority over Alpha under the general control priority rule of paragraph (1).

4. **Conflicting Security Interests Perfected by Control: Priority of Securities Intermediary or Commodity Intermediary.** Paragraphs (2) through (4) govern the priority of conflicting security interests each of which is perfected by control. The following example explains the application of the rules in paragraphs (3) and (4):

Example 5: Debtor holds securities through a securities account with Able & Co. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor borrows from Beta and grants Beta a security interest in 1000 shares of XYZ Co. stock carried in the account. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Debtor incurs obligations to Able and later defaults on the obligations to Beta and Able. Both Beta and Able have control, so the general control priority rule of paragraph (1) does not apply. Compare Example 4. Paragraph (3) provides that a security interest held by a securities intermediary in positions of its own customer has priority over a conflicting security interest of an external lender, so Able has priority over Beta. (Paragraph (4) contains a parallel rule for commodity intermediaries.) The agreement among Able, Beta, and Debtor could, of course, determine the relative priority of the security interests of Able and Beta, see Section 9-339, but the fact that the intermediary has agreed to act on the instructions of a secured party such as Beta does not itself imply any agreement by the intermediary to subordinate.

5. **Conflicting Security Interests Perfected by Control: Temporal Priority.** Former Section 9-115 introduced into Article 9 the concept of conflicting security interests that rank equally. Paragraph (2) of this section governs priority in those circumstances in which more than one secured party (other than a broker, securities intermediary, or commodity intermediary) has control. It replaces the equal-priority rule for conflicting security interests in investment property with a temporal rule. For securities, both certificated and uncertificated, under paragraph (2)(A) priority is based on the time that control is obtained. For security entitlements carried in securities accounts, the treatment is more complex. Paragraph (2)(B) bases priority on the timing of the steps taken to achieve control. The following example illustrates the application of paragraph (2).

Example 6: Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through a securities account with Able & Co. Debtor, Able, and Alpha enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Alpha will also have the right to direct dispositions and receive the proceeds. Later, Debtor borrows from Beta and grants Beta a security interest in all its investment property, existing and after-acquired. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Alpha and Beta both have perfected-by-control security interests in the security entitlement to the XYZ Co. stock by virtue of their agreements with Able. See Sections 9-314(a), 9-106(a), 8-106(d)(2). Under paragraph (2)(B)(ii), the priority of each security interest dates from the time of the secured party's agreement with Able. Because Alpha's agreement was first in time, Alpha has priority. This priority applies equally to security entitlements to financial assets credited to the account after the agreement was entered into.

The priority rule is analogous to "first-to-file" priority under Section 9-322 with respect to after-acquired collateral. Paragraphs (2)(B)(i) and (2)(B)(iii) provide similar rules for security entitlements as to which control is obtained by other methods, and paragraph (2)(C) provides a similar rule for commodity contracts carried in a commodity account. Section 8-510 also has been revised to provide a temporal priority conforming to paragraph (2)(B).

6. **Certificated Securities.** A long-standing practice has developed whereby secured parties whose collateral consists of a security evidenced by a security certificate take possession of the security certificate. If the security certificate is in

bearer form, the secured party's acquisition of possession constitutes "delivery" under Section 8-301(a)(1), and the delivery constitutes "control" under Section 8-106(a). Comment 5 discusses the priority of security interests perfected by control of investment property.

If the security certificate is in registered form, the secured party will not achieve control over the security unless the security certificate contains an appropriate indorsement or is (re)registered in the secured party's name. See Section 8-106(b). However, the secured party's acquisition of possession constitutes "delivery" of the security certificate under Section 8-301 and serves to perfect the security interest under Section 9-313(a), even if the security certificate has not been appropriately indorsed and has not been (re)registered in the secured party's name. A security interest perfected by this method has priority over a security interest perfected other than by control (e.g., by filing). See paragraph (5).

The priority rule stated in paragraph (5) may seem anomalous, in that it can afford less favorable treatment to purchasers who buy collateral outright that to those who take a security interest in it. For example, a buyer of a security certificate would cut off a security interest perfected by filing only if the buyer achieves the status of a protected purchaser under Section 8-303. The buyer would not be a protected purchaser, for example, if it does not obtain "control" under Section 8-106 (e.g., if it fails to obtain a proper indorsement of the certificate) or if it had notice of an adverse claim under Section 8-105. The apparent anomaly disappears, however, when one understands the priority rule not as one intended to protect careless or guilty parties, but as one that eliminates the need to conduct a search of the public records only insofar as necessary to serve the needs of the securities markets.

7. **Secured Financing of Securities Firms.** Priority questions concerning security interests granted by brokers and securities intermediaries are governed by the general control-beats-non-control priority rule of paragraph (1), as supplemented by the special rules set out in paragraphs (2) (temporal priority first to control), (3) (special priority for securities intermediary), and (6) (equal priority for non-control). The following examples illustrate the priority rules as applied to this setting. (In all cases it is assumed that the debtor retains sufficient other securities to satisfy all customers' claims. This section deals with the relative rights of secured lenders to a securities firm. Disputes between a secured lender and the firm's own customers are governed by Section 8-511.)

Example 7: Able & Co., a securities dealer, enters into financing arrangements with two lenders, Alpha Bank and Beta Bank. In each case the agreements provide that the lender will have a security interest in the securities identified on lists provided to the lender on a daily basis, that the debtor will deliver the securities to the lender on demand, and that the debtor will not list as collateral any securities which the debtor has pledged to any other lender. Upon Able's insolvency it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Alpha and Beta both have perfected security interests under the automatic-perfection rule of Section 9-309(10). Neither Alpha nor Beta has control. Paragraph (6) provides that the security interests of Alpha and Beta rank equally, because each of them has a non-control security interest granted by a securities firm. They share pro-rata.

Example 8: Able enters into financing arrangements, with Alpha Bank and Beta Bank as in Example 7. At some point, however, Beta decides that it is unwilling to continue to provide financing on a non-control basis. Able directs the clearing corporation where it holds its principal inventory of securities to move specified securities into Beta's account. Upon Able's insolvency it is discovered that a list of collateral provided to Alpha includes securities that had been moved to Beta's account. Both Alpha and Beta have perfected security interests; Alpha under the automatic-perfection rule of Section 9-309(10), and Beta under that rule and also the perfection-by-control rule in Section 9-314(a). Beta has control but Alpha does not. Beta has priority over Alpha under paragraph (1).

Example 9: Able & Co. carries its principal inventory of securities through Clearing Corporation, which offers a "shared control" facility whereby a participant securities firm can enter into an arrangement with a lender under which the securities firm will retain the power to trade and otherwise direct dispositions of securities carried in its account, but Clearing Corporation agrees that, at any time the lender so directs, Clearing Corporation will transfer any securities from the firm's account to the lender's account or otherwise dispose of them as directed by the lender. Able enters into financing arrangements with two lenders, Alpha and Beta, each of which obtains such a control agreement from Clearing Corporation. The agreement with each lender provides that Able will designate specific securities as collateral on lists provided to the lender on a daily or other periodic basis, and that it will not pledge the same securities to different lenders. Upon Able's insolvency, it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Both Alpha and Beta have control over the disputed securities. Paragraph (2) awards priority to whichever secured party first entered into the agreement with Clearing Corporation.

8. **Relation to Other Law.** Section 1-103 provides that "unless displaced by particular

provisions of this Act, the principles of law and equity . . . shall supplement its provisions." There may be circumstances in which a secured party's action in acquiring a security interest that has priority under this section constitutes conduct that is wrongful under other law. Though the possibility of such resort to other law may provide an appropriate "escape valve" for cases of egregious conduct, care must be taken to ensure that this does not impair the certainty and predictability of the priority rules. Whether a court may appropriately look to other law to impose liability upon or estop a secured party from asserting its Article 9 priority depends on an assessment of the secured party's conduct under the standards established by such other law as well as a determination of whether the particular application of such other law is displaced by the UCC.

Some circumstances in which other law is clearly displaced by the UCC rules are readily identifiable. Common law "first in time, first in right" principles, or correlative tort liability rules such as common law conversion principles under which a purchaser may incur liability to a person with a prior property interest without regard to awareness of that claim, are necessarily displaced by the priority rules set out in this section since these rules determine the relative ranking of security interests in investment property. So too, Article 8 provides protections against adverse claims to certain purchasers of interests in investment property. In circumstances where a secured party not only has priority under Section 9-328, but also qualifies for protection against adverse claims under Section 8-303, 8-502, or 8-510, resort to other law would be precluded.

In determining whether it is appropriate in a particular case to look to other law, account must also be taken of the policies that underlie the commercial law rules on securities markets and security interests in securities. A principal objective of the 1994 revision of Article 8 and the provisions of Article 9 governing investment property was to ensure that secured financing transactions can be implemented on a simple, timely, and certain basis. One of the circumstances that led to the revision was the concern that uncertainty in the application of the rules on secured transactions involving securities and other financial assets could contribute to systemic risk by impairing the ability of financial institutions to provide liquidity to the markets in times of stress. The control priority rule is designed to provide a clear and certain rule to ensure that lenders who have taken the necessary steps to establish control do not face a risk of subordination to other lenders who have not done so.

The control priority rule does not turn on an inquiry into the state of a secured party's awareness of potential conflicting claims because a rule under which a person's rights depended on that sort of after-the-fact inquiry could introduce an unacceptable measure of uncertainty. If an inquiry into awareness could provide a complete and satisfactory resolution of the problem in all cases, the priority rules of this section would have incorporated that test. The fact that they do not necessarily means that resort to other law based solely on that factor is precluded, though the question whether a control secured party induced or encouraged its financing arrangement with actual knowledge that the debtor would be violating the rights of another secured party may, in some circumstances, appropriately be treated as a factor in determining whether the control party's action is the kind of egregious conduct for which resort to other law is appropriate.

4-9-329. Priority of security interests in letter-of-credit right. The following rules govern priority among conflicting security interests in the same letter-of-credit right:

(1) A security interest held by a secured party having control of the letter-of-credit right under section 4-9-107 has priority to the extent of its control over a conflicting security interest held by a secured party that does not have control.

(2) Security interests perfected by control under section 4-9-314 rank according to priority in time of obtaining control.

Source: L. 2001: Entire article R&RE, p. 1364, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New; loosely modeled after former Section 9-115(5).

2. **General Rule.** Paragraph (1) awards priority to a secured party who perfects a security interest directly in letter-of-credit rights (i.e., one that takes an assignment of proceeds and obtains consent of the issuer or any nominated person under Section 5-114(c)) over another conflicting security interest (i.e., one that is perfected automatically in the letter-of-credit rights as supporting obligations under Section 9-308(d)). This is consistent with international letter-of-credit practice and provides finality to payments made to recognized assignees of letter-of-credit proceeds. If an issuer or nominated person recognizes multiple security interests in a

letter-of-credit right, resulting in multiple parties having control (Section 9-107), under paragraph (2) the security interests rank according to the time of obtaining control.

3. **Drawing Rights; Transferee Beneficiaries.** Drawing under a letter of credit is personal to the beneficiary and requires the beneficiary to perform the conditions for drawing under the letter of credit. Accordingly, a beneficiary's grant of a security interest in a letter of credit includes the beneficiary's "letter-of-credit right" as defined in Section 9-102 and the right to "proceeds of [the] letter of credit" as defined in Section 5-114(a), but does not include the right to demand payment under the letter of credit.

Section 5-114(e) provides that the "[r]ights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds." To the extent the rights of a transferee beneficiary or nominated person are independent and superior, this Article does not apply. See Section 9-109(c).

Under Article 5, there is in effect a novation upon the transfer with the issuer becoming bound on a new, independent obligation to the transferee. The rights of nominated persons and transferee beneficiaries under a letter of credit include the right to demand payment from the issuer. Under Section 5-114(e), their rights to payment are independent of their obligations to the beneficiary (or original beneficiary) and superior to the rights of assignees of letter-of-credit proceeds (Section 5-114(c)) and others claiming a security interest in the beneficiary's (or original beneficiary's) letter-of-credit rights.

A transfer of drawing rights under a transferable letter of credit establishes independent Article 5 rights in the transferee and does not create or perfect an Article 9 security interest in the transferred drawing rights. The definition of "letter-of-credit right" in Section 9-102 excludes a beneficiary's drawing rights. The exercise of drawing rights by a transferee beneficiary may breach a contractual obligation of the transferee to the original beneficiary concerning when and how much the transferee may draw or how it may use the funds received under the letter of credit. If, for example, drawing rights are transferred to support a sale or loan from the transferee to the original beneficiary, then the transferee would be obligated to the original beneficiary under the sale or loan agreement to account for any drawing and for the use of any funds received. The transferee's obligation would be governed by the applicable law of contracts or restitution.

4. **Secured Party-Transferee Beneficiaries.** As described in Comment 3, drawing rights under letters of credit are transferred in many commercial contexts in which the transferee is not a secured party claiming a security interest in an underlying receivable supported by the letter of credit. Consequently, a transfer of a letter of credit is not a method of "perfection" of a security interest. The transferee's independent right to draw under the letter of credit and to receive and retain the value thereunder (in effect, priority) is not based on Article 9 but on letter-of-credit law and the terms of the letter of credit. Assume, however, that a secured party does hold a security interest in a receivable that is owned by a beneficiary-debtor and supported by a transferable letter of credit. Assume further that the beneficiary-debtor causes the letter of credit to be transferred to the secured party, the secured party draws under the letter of credit, and, upon the issuer's payment to the secured party-transferee, the underlying account debtor's obligation to the original beneficiary-debtor is satisfied. In this situation, the payment to the secured party-transferee is proceeds of the receivable collected by the secured party-transferee. Consequently, the secured party-transferee would have certain duties to the debtor and third parties under Article 9. For example, it would be obliged to collect under the letter of credit in a commercially reasonable manner and to remit any surplus pursuant to Sections 9-607 and 9-608.

This scenario is problematic under letter-of-credit law and practice, inasmuch as a transferee beneficiary collects in its own right arising from its own performance. Accordingly, under Section 5-114, the independent and superior rights of a transferee control over any inconsistent duties under Article 9. A transferee beneficiary may take a transfer of drawing rights to avoid reliance on the original beneficiary's credit and collateral, and it may consider any Article 9 rights superseded by its Article 5 rights. Moreover, it will not always be clear (i) whether a transferee beneficiary has a security interest in the underlying collateral, (ii) whether any security interest is senior to the rights of others, or (iii) whether the transferee beneficiary is aware that it holds a security interest. There will be clear cases in which the role of a transferee beneficiary as such is merely incidental to a conventional secured financing. There also will be cases in which the existence of a security interest may have little to do with the position of a transferee beneficiary as such. In dealing with these cases and less clear cases involving the possible application of Article 9 to a nominated person or a transferee beneficiary, the right to demand payment under a letter of credit should be distinguished from letter-of-credit rights. The courts also should give appropriate consideration to the policies and provisions of Article 5 and letter-of-credit practice as well as Article 9.

4-9-330. Priority of purchaser of chattel paper or instrument. (a) A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory subject to a security interest if:

(1) In good faith and in the ordinary course of the purchaser's business, the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under section 4-9-105; and

(2) The chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.

(b) A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed other than merely as proceeds of inventory subject to a security interest if the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under section 4-9-105 in good faith, in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of the secured party.

(c) Except as otherwise provided in section 4-9-327, a purchaser having priority in chattel paper under subsection (a) or (b) of this section also has priority in proceeds of the chattel paper to the extent that:

(1) Section 4-9-322 provides for priority in the proceeds; or

(2) The proceeds consist of the specific goods covered by the chattel paper or cash proceeds of the specific goods, even if the purchaser's security interest in the proceeds is unperfected.

(d) Except as otherwise provided in section 4-9-331 (a), a purchaser of an instrument has priority over a security interest in the instrument perfected by a method other than possession if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party.

(e) For purposes of subsections (a) and (b) of this section, the holder of a purchase-money security interest in inventory gives new value for chattel paper constituting proceeds of the inventory.

(f) For purposes of subsections (b) and (d) of this section, if chattel paper or an instrument indicates that it has been assigned to an identified secured party other than the purchaser, a purchaser of the chattel paper or instrument has knowledge that the purchase violates the rights of the secured party.

Source: L. 2001: Entire article R&RE, p. 1364, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-308 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-308.

2. **Non-Temporal Priority.** This Article permits a security interest in chattel paper or instruments to be perfected either by filing or by the secured party's taking possession. This section enables secured parties and other purchasers of chattel paper (both electronic and tangible) and instruments to obtain priority over earlier-perfected security interests, [thereby promoting the negotiability of these types of receivables.]

Note: The bracketed language takes effect July 1, 2013.

3. **Chattel Paper.** Subsections (a) and (b) follow former Section 9-308 in distinguishing between earlier-perfected security interests in chattel paper that is claimed merely as proceeds of inventory subject to a security interest and chattel paper that is claimed other than merely as proceeds. Like former Section 9-308, this section does not elaborate upon the phrase "merely as proceeds." For an elaboration, see PEB Commentary No. 8.

This section makes explicit the "good faith" requirement and retains the requirements of "the ordinary course of the purchaser's business" and the giving of "new value" as conditions for priority. Concerning the last, this Article deletes former Section 9-108 and adds to Section 9-102 a completely different definition of the term "new value." Under subsection (e), the holder of a purchase-money security interest in inventory is deemed to give "new value" for chattel paper constituting the proceeds of the inventory. Accordingly, the purchase-money secured party may qualify for priority in the chattel paper under subsection (a) or (b), whichever is applicable, even if it does not make an additional advance against the chattel paper.

If a possessory security interest in tangible chattel paper or a perfected-by-control security

interest in electronic chattel paper does not qualify for priority under this section, it may be subordinate to a perfected-by-filing security interest under Section 9-322(a)(1).

4. **Possession.** The priority afforded by this section turns in part on whether a purchaser "takes possession" of tangible chattel paper. Similarly, the governing law provisions in Section 9-301 address both "possessory" and "non-possessory" security interests. Two common practices have raised particular concerns. First, in some cases the parties create more than one copy or counterpart of chattel paper evidencing a single secured obligation or lease. This practice raises questions as to which counterpart is the "original" and whether it is necessary for a purchaser to take possession of all counterparts in order to "take possession" of the chattel paper. Second, parties sometimes enter into a single "master" agreement. The master agreement contemplates that the parties will enter into separate "schedules" from time to time, each evidencing chattel paper. Must a purchaser of an obligation or lease evidenced by a single schedule also take possession of the master agreement as well as the schedule in order to "take possession" of the chattel paper?

The problem raised by the first practice is easily solved. The parties may in the terms of their agreement and by designation on the chattel paper identify only one counterpart as the original chattel paper for purposes of taking possession of the chattel paper. Concerns about the second practice also are easily solved by careful drafting. Each schedule should provide that it incorporates the terms of the master agreement, not the other way around. This will make it clear that each schedule is a "stand alone" document.

Note: This version of paragraph 4. is effective until July 1, 2013.

4. **Possession and Control.** To qualify for priority under subsection (a) or (b), a purchaser must "take[ ] possession of the chattel paper or obtain[ ] control of the chattel paper under Section 9-105." When chattel paper comprises one or more tangible records and one or more electronic records, a purchaser may satisfy the possession-or-control requirement by taking possession of the tangible records under Section 9-313 and having control of the electronic records under Section 9-105. In determining which of several related records constitutes chattel paper and thus is relevant to possession or control, the form of the records is irrelevant. Rather, the touchstone is whether possession or control of the record would afford the public notice contemplated by the possession and control requirements. For example, because possession or control of an amendment extending the term of a lease would not afford the contemplated public notice, the amendment would not constitute chattel paper regardless of whether the amendment is in tangible form and the lease is in electronic form, the amendment is electronic and the lease is tangible, the amendment and lease are both tangible, or the amendment and lease are both electronic.

Two common practices have raised particular concerns with respect to the possession requirement. First, in some cases the parties create more than one copy or counterpart of chattel paper evidencing a single secured obligation or lease. This practice raises questions as to which counterpart is the "original" and whether it is necessary for a purchaser to take possession of all counterparts in order to "take possession" of the chattel paper. Second, parties sometimes enter into a single "master" agreement. The master agreement contemplates that the parties will enter into separate "schedules" from time to time, each evidencing chattel paper. Must a purchaser of an obligation or lease evidenced by a single schedule also take possession of the master agreement as well as the schedule in order to "take possession" of the chattel paper?

The problem raised by the first practice is easily solved. The parties may in the terms of their agreement and by designation on the chattel paper identify only one counterpart as the original chattel paper for purposes of taking possession of the chattel paper. Concerns about the second practice also are easily solved by careful drafting. Each schedule should provide that it incorporates the terms of the master agreement, not the other way around. This will make it clear that each schedule is a "stand alone" document.

A secured party may wish to convert tangible chattel paper to electronic chattel paper and vice versa. The priority of a security interest in chattel paper under subsection (a) or (b) may be preserved, even if the form of the chattel paper changes. The principle implied in the preceding paragraph, i.e., that not every copy of chattel paper is relevant, applies to "control" as well as to "possession." When there are multiple copies of chattel paper, a secured party may take "possession" or obtain "control" of the chattel paper if it acts with respect to the copy or copies that are reliably identified as the copy or copies that are relevant for purposes of possession or control. This principle applies as well to chattel paper that has been converted from one form to another, even if the relevant copies are not the "original" chattel paper.

Note: This version of paragraph 4. is effective July 1, 2013.

5. **Chattel Paper Claimed Merely as Proceeds.** Subsection (a) revises the rule in former Section 9-308(b) to eliminate reference to what the purchaser knows. Instead, a purchaser who meets the possession or control, ordinary course, and new value requirements takes priority over a competing security interest unless the chattel paper itself indicates that it has been assigned to

an identified assignee other than the purchaser. Thus subsection (a) recognizes the common practice of placing a "legend" on chattel paper to indicate that it has been assigned. This approach, under which the chattel paper purchaser who gives new value in ordinary course can rely on possession of unlegended, tangible chattel paper without any concern for other facts that it may know, comports with the expectations of both inventory and chattel paper financers.

6. **Chattel Paper Claimed Other Than Merely as Proceeds.** Subsection (b) eliminates the requirement that the purchaser take without knowledge that the "specific paper" is subject to the security interest and substitutes for it the requirement that the purchaser take "without knowledge that the purchase violates the rights of the secured party." This standard derives from the definition of "buyer in ordinary course of business" in Section 1-201(9). The source of the purchaser's knowledge is irrelevant. Note, however, that "knowledge" means "actual knowledge." Section 1-201(25).

Note: "1-201(9)." and "1-201(25)." will be replaced with "1-201(b)(9)." and "1-202(b).", respectively, effective July 1, 2013.

In contrast to a junior secured party in accounts, who may be required in some special circumstances to undertake a search under the "good faith" requirement, see Comment 5 to Section 9-331, a purchaser of chattel paper under this section is not required as a matter of good faith to make a search in order to determine the existence of prior security interests. There may be circumstances where the purchaser undertakes a search nevertheless, either on its own volition or because other considerations make it advisable to do so, e.g., where the purchaser also is purchasing accounts. Without more, a purchaser of chattel paper who has seen a financing statement covering the chattel paper or who knows that the chattel paper is encumbered with a security interest, does not have knowledge that its purchase violates the secured party's rights. However, if a purchaser sees a statement in a financing statement to the effect that a purchase of chattel paper from the debtor would violate the rights of the filed secured party, the purchaser would have such knowledge. Likewise, under new subsection (f), if the chattel paper itself indicates that it had been assigned to an identified secured party other than the purchaser, the purchaser would have wrongful knowledge for purposes of subsection (b), thereby preventing the purchaser from qualifying for priority under that subsection, even if the purchaser did not have actual knowledge. In the case of tangible chattel paper, the indication normally would consist of a written legend on the chattel paper. In the case of electronic chattel paper, this Article leaves to developing market and technological practices the manner in which the chattel paper would indicate an assignment.

7. **Instruments.** Subsection (d) contains a special priority rule for instruments. Under this subsection, a purchaser of an instrument has priority over a security interest perfected by a method other than possession (e.g., by filing, temporarily under Section 9-312(e) or (g), as proceeds under Section 9-315(d), or automatically upon attachment under Section 9-309(4) if the security interest arises out of a sale of the instrument) if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party. Generally, to the extent subsection (d) conflicts with Section 3-306, subsection (d) governs. See Section 3-102(b). For example, notice of a conflicting security interest precludes a purchaser from becoming a holder in due course under Section 3-302 and thereby taking free of all claims to the instrument under Section 3-306. However, a purchaser who takes even with knowledge of the security interest qualifies for priority under subsection (d) if it takes without knowledge that the purchase violates the rights of the holder of the security interest. Likewise, a purchaser qualifies for priority under subsection (d) if it takes for "value" as defined in Section 1-201, even if it does not take for "value" as defined in Section 3-303.

Subsection (d) is subject to Section 9-331(a), which provides that Article 9 does not limit the rights of a holder in due course under Article 3. Thus, in the rare case in which the purchaser of an instrument qualifies for priority under subsection (d), but another person has the rights of a holder in due course of the instrument, the other person takes free of the purchaser's claim. See Section 3-306.

The rule in subsection (d) is similar to the rules in subsections (a) and (b), which govern priority in chattel paper. The observations in Comment 6 concerning the requirement of good faith and the phrase "without knowledge that the purchase violates the rights of the secured party" apply equally to purchasers of instruments. However, unlike a purchaser of chattel paper, to qualify for priority under this section a purchaser of an instrument need only give "value" as defined in Section 1-201; it need not give "new value." Also, the purchaser need not purchase the instrument in the ordinary course of its business.

Subsection (d) applies to checks as well as notes. For example, to collect and retain checks that are proceeds (collections) of accounts free of a senior secured party's claim to the same checks, a junior secured party must satisfy the good-faith requirement (honesty in fact and the observance of reasonable commercial standards of fair dealing) of this subsection. This is the same good-faith requirement applicable to holders in due course. See Section 9-331, Comment 5.

8. **Priority in Proceeds of Chattel Paper.** Subsection (c) sets forth the two circumstances under which the priority afforded to a purchaser of chattel paper under subsection (a) or (b) extends also to proceeds of the chattel paper. The first is if the purchaser would have priority under the normal priority rules applicable to proceeds. The second, which the following Comments discuss in greater detail, is if the proceeds consist of the specific goods covered by the chattel paper. Former Article 9 generally was silent as to the priority of a security interest in proceeds when a purchaser qualifies for priority under Section 9-308 (but see former Section 9-306(5)(b), concerning returned and repossessed goods).

9. **Priority in Returned and Repossessed Goods.** Returned and repossessed goods may constitute proceeds of chattel paper. The following Comments explain the treatment of returned and repossessed goods as proceeds of chattel paper. The analysis is consistent with that of PEB Commentary No. 5, which these Comments replace, and is based upon the following example:

Example: SP-1 has a security interest in all the inventory of a dealer in goods (Dealer); SP-1's security interest is perfected by filing. Dealer sells some of its inventory to a buyer in the ordinary course of business (BIOCOB) pursuant to a conditional sales contract (chattel paper) that does not indicate that it has been assigned to SP-1. SP-2 purchases the chattel paper from Dealer and takes possession of the paper in good faith, in the ordinary course of business, and without knowledge that the purchase violates the rights of SP-1. Subsequently, BIOCOB returns the goods to Dealer because they are defective. Alternatively, Dealer acquires possession of the goods following BIOCOB's default.

10. **Assignment of Non-Lease Chattel Paper.**

a. **Loan by SP-2 to Dealer Secured by Chattel Paper (or Functional Equivalent Pursuant to Recourse Arrangement).**

(1) **Returned Goods.** If BIOCOB returns the goods to Dealer for repairs, Dealer is merely a bailee and acquires thereby no meaningful rights in the goods to which SP-1's security interest could attach. (Although SP-1's security interest could attach to Dealer's interest as a bailee, that interest is not likely to be of any particular value to SP-1.) Dealer is the owner of the *chattel paper* (i.e., the owner of a right to payment secured by a security interest in the goods); SP-2 has a security interest in the chattel paper, as does SP-1 (as proceeds of the goods under Section 9-315). Under Section 9-330, SP-2's security interest in the chattel paper is senior to that of SP-1. SP-2 enjoys this priority regardless of whether, or when, SP-2 filed a financing statement covering the chattel paper. Because chattel paper and goods represent different types of collateral, Dealer does not have any meaningful interest in *goods* to which either SP-1's or SP-2's security interest could attach in order to secure Dealer's obligations to either creditor. See Section 9-102 (defining "chattel paper" and "goods").

Now assume that BIOCOB returns the goods to Dealer under circumstances whereby Dealer once again becomes the owner of the goods. This would be the case, for example, if the goods were defective and BIOCOB was entitled to reject or revoke acceptance of the goods. See Sections 2-602 (rejection), 2-608 (revocation of acceptance). Unless BIOCOB has waived its defenses as against assignees of the chattel paper, SP-1's and SP-2's rights against BIOCOB would be subject to BIOCOB's claims and defenses. See Sections 9-403, 9-404. SP-1's security interest would attach again because the returned goods would be proceeds of the chattel paper. Dealer's acquisition of the goods easily can be characterized as "proceeds" consisting of an "in kind" collection on or distribution on account of the chattel paper. See Section 9-102 (definition of "proceeds"). Assuming that SP-1's security interest is perfected by filing against the goods and that the filing is made in the same office where a filing would be made against the chattel paper, SP-1's security interest in the goods would remain perfected beyond the 20-day period of automatic perfection. See Section 9-315(d).

Because Dealer's newly reacquired interest in the goods is proceeds of the chattel paper, SP-2's security interest also would attach in the goods as proceeds. If SP-2 had perfected its security interest in the chattel paper by filing (again, assuming that filing against the chattel paper was made in the same office where a filing would be made against the goods), SP-2's security interest in the reacquired goods would be perfected beyond 20 days. See Section 9-315(d). However, if SP-2 had relied only on its possession of the chattel paper for perfection and had not filed against the chattel paper or the goods, SP-2's security interest would be unperfected after the 20-day period. See Section 9-315(d). Nevertheless, SP-2's unperfected security interest in the goods would be senior to SP-1's security interest under Section 9-330(c). The result in this priority contest is not affected by SP-2's acquiescence or non-acquiescence in the return of the goods to Dealer.

(2) **Repossessed Goods.** As explained above, Dealer owns the chattel paper covering the goods, subject to security interests in favor of SP-1 and SP-2. In Article 9 parlance, Dealer has an interest in chattel paper, not goods. If Dealer, SP-1, or SP-2 repossesses the goods upon BIOCOB's default, whether the repossession is rightful or wrongful as among Dealer, SP-1, or SP-2, Dealer's interest will not change. The

location of goods and the party who possesses them does not affect the fact that Dealer's interest is in chattel paper, not goods. The goods continue to be owned by BIOCOB. SP-1's security interest in the goods does not attach until such time as Dealer reacquires an interest (other than a bare possessory interest) in the goods. For example, Dealer might buy the goods at a foreclosure sale from SP-2 (whose security interest in the chattel paper is senior to that of SP-1); that disposition would cut off BIOCOB's rights in the goods. Section 9-617.

In many cases the matter would end upon sale of the goods to Dealer at a foreclosure sale and there would be no priority contest between SP-1 and SP-2; Dealer would be unlikely to buy the goods under circumstances whereby SP-2 would retain its security interest. There can be exceptions, however. For example, Dealer may be obliged to purchase the goods from SP-2 and SP-2 may be obliged to convey the goods to Dealer, but Dealer may fail to pay SP-2. Or, one could imagine that SP-2, like SP-1, has a general security interest in the inventory of Dealer. In the latter case, SP-2 should not receive the benefit of any special priority rule, since its interest in no way derives from priority under Section 9-330. In the former case, SP-2's security interest in the goods reacquired by Dealer is senior to SP-1's security interest under Section 9-330.

b. **Dealer's Outright Sale of Chattel Paper to SP-2.** Article 9 also applies to a transaction whereby SP-2 buys the chattel paper in an outright sale transaction without recourse against Dealer. Sections 1-201(37), 9-109(a). Although Dealer does not, in such a transaction, retain any residual ownership interest in the chattel paper, the chattel paper constitutes proceeds of the goods to which SP-1's security interest will attach and continue following the sale of the goods. Section 9-315(a). Even though Dealer has not retained any interest in the chattel paper, as discussed above BIOCOB subsequently may return the goods to Dealer under circumstances whereby Dealer reacquires an interest in the goods. The priority contest between SP-1 and SP-2 will be resolved as discussed above; Section 9-330 makes no distinction among purchasers of chattel paper on the basis of whether the purchaser is an outright buyer of chattel paper or one whose security interest secures an obligation of Dealer.

11. **Assignment of Lease Chattel Paper.** As defined in Section 9-102, "chattel paper" includes not only writings that evidence security interests in specific goods but also those that evidence true leases of goods.

The analysis with respect to lease chattel paper is similar to that set forth above with respect to non-lease chattel paper. It is complicated, however, by the fact that, unlike the case of chattel paper arising out of a sale, Dealer retains a residual interest in the *goods*. See Section 2A-103(1)(q) (defining "lessor's residual interest"); *In re Leasing Consultants, Inc.*, 486 F.2d 367 (2d Cir. 1973) (lessor's residual interest under true lease is an interest in goods and is a separate type of collateral from lessor's interest in the lease). If Dealer leases goods to a "lessee in ordinary course of business" (LIOCOB), then LIOCOB takes its interest under the lease (i.e., its "leasehold interest") free of the security interest of SP-1. See Sections 2A-307(3), 2A-103(1)(m) (defining "leasehold interest"), (1)(o) (defining "lessee in ordinary course of business"). SP-1 would, however, retain its security interest in the residual interest. In addition, SP-1 would acquire an interest in the lease chattel paper as proceeds. If Dealer then assigns the lease chattel paper to SP-2, Section 9-330 gives SP-2 priority over SP-1 with respect to the chattel paper, *but not* with respect to the residual interest in the *goods*. Consequently, assignees of lease chattel paper typically take a security interest in and file against the lessor's residual interest in goods, expecting their priority in the goods to be governed by the first-to-file-or-perfect rule of Section 9-322.

If the goods are returned to Dealer, other than upon expiration of the lease term, then the security interests of both SP-1 and SP-2 normally would attach to the goods as proceeds of the chattel paper. (If the goods are returned to Dealer at the expiration of the lease term and the lessee has made all payments due under the lease, however, then Dealer no longer has any rights under the chattel paper. Dealer's interest in the goods consists solely of its residual interest, as to which SP-2 has no claim.) This would be the case, for example, when the lessee rescinds the lease or when the lessor recovers possession in the exercise of its remedies under Article 2A. See, e.g., Section 2A-525. If SP-2 enjoyed priority in the chattel paper under Section 9-330, then SP-2 likewise would enjoy priority in the returned goods as proceeds. This does not mean that SP-2 necessarily is entitled to the entire value of the returned goods. The value of the goods represents the sum of the present value of (i) the value of their use for the term of the lease and (ii) the value of the residual interest. SP-2 has priority in the former, but SP-1 ordinarily would have priority in the latter. Thus, an allocation of a portion of the value of the goods to each component may be necessary. Where, as here, one secured party has a security interest in the lessor's residual interest and another has a priority security interest in the chattel paper, it may be advisable for the conflicting secured parties to establish a method for making such an allocation and otherwise to determine their relative rights in returned goods by agreement.

ANNOTATION

Law reviews. For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

4-9-331. Priority of rights of purchasers of instruments, documents, and securities under other articles - priority of interests in financial assets and security entitlements under article 8. (a) This article does not limit the rights of a holder in due course of a negotiable instrument, a holder to which a negotiable document of title has been duly negotiated, or a protected purchaser of a security. These holders or purchasers take priority over an earlier security interest, even if perfected, to the extent provided in articles 3, 7, and 8 of this title.

(b) This article does not limit the rights of or impose liability on a person to the extent that the person is protected against the assertion of a claim under article 8 of this title.

(c) Filing under this article does not constitute notice of a claim or defense to the holders, or purchasers, or persons described in subsections (a) and (b) of this section.

Source: L. 2001: Entire article R&RE, p. 1365, § 1, effective July 1. **L. 2002:** (b) amended, p. 938, § 6, effective August 7.

Editor's note: This section is similar to former § 4-9-309 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-309.

2. **"Priority."** In some provisions, this Article distinguishes between claimants that take collateral free of a security interest (in the sense that the security interest no longer encumbers the collateral) and those that take an interest in the collateral that is senior to a surviving security interest. See, e.g., Section 9-317. Whether a holder or purchaser referred to in this section takes free or is senior to a security interest depends on whether the purchaser is a buyer of the collateral or takes a security interest in it. The term "priority" is meant to encompass both scenarios, as it does in Section 9-330.

3. **Rights Acquired by Purchasers.** The rights to which this section refers are set forth in Sections 3-305 and 3-306 (holder in due course), 7-502 (holder to whom a negotiable document of title has been duly negotiated), and 8-303 (protected purchaser). The holders and purchasers referred to in this section do not always take priority over a security interest. See, e.g., Section 7-503 (affording paramount rights to certain owners and secured parties as against holder to whom a negotiable document of title has been duly negotiated). Accordingly, this section adds the clause, "to the extent provided in Articles 3, 7, and 8" to former Section 9-309.

4. **Financial Assets and Security Entitlements.** New subsection (b) provides explicit protection for those who deal with financial assets and security entitlements and who are immunized from liability under Article 8. See, e.g., Sections 8-502, 8-503(e), 8-510, 8-511. The new subsection makes explicit in Article 9 what is implicit in former Article 9 and explicit in several provisions of Article 8. It does not change the law.

5. **Collections by Junior Secured Party.** Under this section, a secured party with a junior security interest in receivables (accounts, chattel paper, promissory notes, or payment intangibles) may collect and retain the proceeds of those receivables free of the claim of a senior secured party to the same receivables, if the junior secured party is a holder in due course of the proceeds. In order to qualify as a holder in due course, the junior must satisfy the requirements of Section 3-302, which include taking in "good faith." This means that the junior not only must act "honestly" but also must observe "reasonable commercial standards of fair dealing" under the particular circumstances. See Section 9-102(a). Although "good faith" does not impose a general duty of inquiry, e.g., a search of the records in filing offices, there may be circumstances in which "reasonable commercial standards of fair dealing" would require such a search.

Consider, for example, a junior secured party in the business of financing or buying accounts who fails to undertake a search to determine the existence of prior security interests. Because a search, under the usages of trade of that business, would enable it to know or learn upon reasonable inquiry that collecting the accounts violated the rights of a senior secured party, the junior may fail to meet the good-faith standard. See Utility Contractors Financial Services, Inc. v. Amsouth Bank, NA, 985 F.2d 1554 (11th Cir.

1993). Likewise, a junior secured party who collects accounts when it knows or should know under the particular circumstances that doing so would violate the rights of a senior secured party, because the debtor had agreed not to grant a junior security interest in, or sell, the accounts, may not meet the good-faith test. Thus, if a junior secured party conducted or should have conducted a search and a financing statement filed on behalf of the senior secured party states such a restriction, the junior's collection would not meet the good-faith standard. On the other hand, if there was a course of performance between the senior secured party and the debtor which placed no such restrictions on the debtor and allowed the debtor to collect and use the proceeds without any restrictions, the junior secured party may then satisfy the requirements for being a holder in due course. This would be more likely in those circumstances where the junior secured party was providing additional financing to the debtor on an on-going basis by lending against or buying the accounts and had no notice of any restrictions against doing so. Generally, the senior secured party would not be prejudiced because the practical effect of such payment to the junior secured party is little different than if the debtor itself had made the collections and subsequently paid the secured party from the debtor's general funds. Absent collusion, the junior secured party would take the funds free of the senior security interests. See Section 9-332. In contrast, the senior secured party is likely to be prejudiced if the debtor is going out of business and the junior secured party collects the accounts by notifying the account debtors to make payments directly to the junior. Those collections may not be consistent with "reasonable commercial standards of fair dealing."

Whether the junior secured party qualifies as a holder in due course is fact-sensitive and should be decided on a case-by-case basis in the light of those circumstances. Decisions such as Financial Management Services Inc. v. Familian, 905 P.2d 506 (Ariz. App. Div. 1995) (finding holder in due course status) could be determined differently under this application of the good-faith requirement.

The concepts addressed in this Comment are also applicable to junior secured parties as purchasers of instruments under Section 9-330(d). See Section 9-330, Comment 7.

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

4-9-332. Transfer of money - transfer of funds from deposit account. (a) A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

(b) A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

Source: L. 2001: Entire article R&RE, p. 1366, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.
2. **Scope of This Section.** This section affords broad protection to transferees who take funds from a deposit account and to those who take money. The term "transferee" is not defined; however, the debtor itself is not a transferee. Thus this section does not cover the case in which a debtor withdraws money (currency) from its deposit account or the case in which a bank debits an encumbered account and credits another account it maintains for the debtor.

A transfer of funds from a deposit account, to which subsection (b) applies, normally will be made by check, by funds transfer, or by debiting the debtor's deposit account and crediting another depositor's account.

Example 1: Debtor maintains a deposit account with Bank A. The deposit account is subject to a perfected security interest in favor of Lender. Debtor draws a check on the account, payable to Payee. Inasmuch as the check is not the proceeds of the deposit account (it is an order to pay funds from the deposit account), Lender's security interest in the deposit account does not give rise to a security interest in the check. Payee deposits the check into its own deposit account, and Bank A pays it. Unless Payee acted in collusion with Debtor in violating Lender's rights, Payee takes the funds (the credits running in favor of Payee) free of Lender's security interest. This is true regardless of whether Payee is a holder in due course of the

check and even if Payee gave no value for the check.

Example 2: Debtor maintains a deposit account with Bank A. The deposit account is subject to a perfected security interest in favor of Lender. At Bank B's suggestion, Debtor moves the funds from the account at Bank A to Debtor's deposit account with Bank B. Unless Bank B acted in collusion with Debtor in violating Lender's rights, Bank B takes the funds (the credits running in favor of Bank B) free from Lender's security interest. See subsection (b). However, inasmuch as the deposit account maintained with Bank B constitutes the proceeds of the deposit account at Bank A, Lender's security interest would attach to that account as proceeds. See Section 9-315.

Subsection (b) also would apply if, in the example, Bank A debited Debtor's deposit account in exchange for the issuance of Bank A's cashier's check. Lender's security interest would attach to the cashier's check as proceeds of the deposit account, and the rules applicable to instruments would govern any competing claims to the cashier's check. See, e.g., Sections 3-306, 9-322, 9-330, 9-331.

If Debtor withdraws money (currency) from an encumbered deposit account and transfers the money to a third party, then subsection (a), to the extent not displaced by federal law relating to money, applies. It contains the same rule as subsection (b).

Subsection (b) applies to *transfers of funds from* a deposit account; it does not apply to *transfers of the deposit account* itself or of an interest therein. For example, this section does not apply to the creation of a security interest in a deposit account. Competing claims to the deposit account itself are dealt with by other Article 9 priority rules. See Sections 9- 317(a), 9-327, 9-340, 9-341. Similarly, a corporate merger normally would not result in a transfer of funds from a deposit account. Rather, it might result in a transfer of the deposit account itself. If so, the normal rules applicable to transferred collateral would apply; this section would not.

3. **Policy.** Broad protection for transferees helps to ensure that security interests in deposit accounts do not impair the free flow of funds. It also minimizes the likelihood that a secured party will enjoy a claim to whatever the transferee purchases with the funds. Rules concerning recovery of payments traditionally have placed a high value on finality. The opportunity to upset a completed transaction, or even to place a completed transaction in jeopardy by bringing suit against the transferee of funds, should be severely limited. Although the giving of value usually is a prerequisite for receiving the ability to take free from third-party claims, where payments are concerned the law is even more protective. Thus, Section 3-418(c) provides that, even where the law of restitution otherwise would permit recovery of funds paid by mistake, no recovery may be had from a person "who in good faith changed position in reliance on the payment." Rather than adopt this standard, this section eliminates all reliance requirements whatsoever. Payments made by mistake are relatively rare, but payments of funds from encumbered deposit accounts (e.g., deposit accounts containing collections from accounts receivable) occur with great regularity. In most cases, unlike payment by mistake, no one would object to these payments. In the vast proportion of cases, the transferee probably would be able to show a change of position in reliance on the payment. This section does not put the transferee to the burden of having to make this proof.

4. **"Bad Actors."** To deal with the question of the "bad actor," this section borrows "collusion" language from Article 8. See, e.g., Sections 8-115, 8-503(e). This is the most protective (i.e., least stringent) of the various standards now found in the UCC. Compare, e.g., Section 1-201(9) ("without knowledge that the sale . . . is in violation of the . . . security interest"); Section 1-201(19) ("honesty in fact in the conduct or transaction concerned"); Section 3-302(a)(2)(v) ("without notice of any claim"). **Note:** This version of this paragraph 4. is effective until July 1, 2013.

4. **"Bad Actors."** To deal with the question of the "bad actor," this section borrows "collusion" language from Article 8. See, e.g., Sections 8-115, 8-503(e). This is the most protective (i.e., least stringent) of the various standards now found in the UCC. Compare, e.g., Section 1-201(b)(9) ("without knowledge that the sale violates the rights of another person"); Section 1-201(b)(20) ("honesty in fact and the observance of reasonable commercial standards of fair dealing"); Section 3-302(a)(2)(v) ("without notice of any claim").

Note: This version of this paragraph 4. is effective July 1, 2013.

5. **Transferee Who Does Not Take Free.** This section sets forth the circumstances under which certain transferees of money or funds take free of security interests. It does not determine the rights of a transferee who does not take free of a security interest.

Example 3: The facts are as in Example 2, but, in wrongfully moving the funds from the deposit account at Bank A to Debtor's deposit account with Bank B, Debtor acts in collusion with Bank B. Bank B does not take the funds free of Lender's security interest under this section. If Debtor grants a security interest to Bank B, Section 9-327 governs the relative priorities of Lender and Bank B. Under Section 9-327(3), Bank B's security interest in the Bank B deposit account is senior to Lender's security interest in

the deposit account as proceeds. However, Bank B's senior security interest does not protect Bank B against any liability to Lender that might arise from Bank B's wrongful conduct.

4-9-333. Priority of certain liens arising by operation of law. (a) In this section, "possessory lien" means an interest, other than a security interest or an agricultural lien:

(1) Which secures payment or performance of an obligation for services or materials furnished with respect to goods by a person in the ordinary course of the person's business;

(2) Which is created by statute or rule of law in favor of the person; and

(3) Whose effectiveness depends on the person's possession of the goods.

(b) A possessory lien on goods has priority over a security interest in the goods if the lien is created by a statute that expressly so provides.

Source: L. 2001: Entire article R&RE, p. 1366, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-310 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado substituted the word "if" for "unless" and substituted the phrase "so provides" for "provides otherwise" in subsection (b).

OFFICIAL COMMENT

1. **Source.** Former Section 9-310.
2. **"Possessory Liens."** This section governs the relative priority of security interests arising under this Article and "possessory liens," i.e., common-law and statutory liens whose effectiveness depends on the lienor's possession of goods with respect to which the lienor provided services or furnished materials in the ordinary course of its business. As under former Section 9-310, the possessory lien has priority over a security interest unless the possessory lien is created by a statute that expressly provides otherwise. If the statute creating the possessory lien is silent as to its priority relative to a security interest, this section provides a rule of interpretation that the possessory lien takes priority, even if the statute has been construed judicially to make the possessory lien subordinate.

ANNOTATION

Law reviews. For article, "Oil and Gas Financing Under the Uniform Commercial Code as Enacted in Colorado", see 43 Den. L.J. 129 (1966). For article, "Secured Transactions — Part 1: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

Annotator's note. Since § 4-9-333 is similar to § 4-9-310 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

The Colorado general assembly changed this section from the section promulgated by the national conference of commissioners on uniform state laws, so that the Colorado statute expressly provides that the repairman's lien "does not take priority over a perfected security interest unless a statute expressly provides otherwise", which maintains prior law by giving the repairman an inferior priority status. First Security Bank v. Crouse, 374 F.2d 17 (10th Cir. 1967), rev'g 252 F. Supp. 230 (D. Colo. 1966).

Attorney's lien, as a statutory first lien, has priority over a bank's previously perfected security interest. N. Valley Bank v. McGloin, Davenport, 251 P.3d 1250 (Colo. App. 2010).

A court cannot, through ancillary proceedings, place a judgment creditor in a better or more favorable position than he would be in if levy were made upon the property. Hilst v. Bennett, 175 Colo. 78, 485 P.2d 880 (1971).

A court cannot require posting a bond. In ancillary proceedings in aid of execution on a judgment there is no jurisdiction in the courts to require a creditor to post a bond to secure payment of the judgment. Hilst v. Bennett, 175 Colo. 78, 485 P.2d 880 (1971).

4-9-334. Priority of security interests in fixtures and crops. (a) A security interest under this article may be created in goods that are fixtures or may continue in goods that become fixtures. A security interest does not exist under this article in ordinary building materials incorporated into an improvement on land.

(b) This article does not prevent creation of an encumbrance upon fixtures under real property law.

(c) In cases not governed by subsections (d) to (h) of this section, a security interest in

fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real property other than the debtor.

(d) Except as otherwise provided in subsection (h) of this section, a perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property and:

(1) The security interest is a purchase-money security interest;

(2) The interest of the encumbrancer or owner arises before the goods become fixtures; and

(3) The security interest is perfected by a fixture filing before the goods become fixtures or within twenty days thereafter.

(e) A perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if:

(1) The debtor has an interest of record in the real property or is in possession of the real property and the security interest:

(A) Is perfected by a fixture filing before the interest of the encumbrancer or owner is of record; and

(B) Has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner;

(2) Before the goods become fixtures, the security interest is perfected by any method permitted by this article and the fixtures are readily removable:

(A) Factory or office machines;

(B) Equipment that is not primarily used or leased for use in the operation of the real property; or

(C) Replacements of domestic appliances that are consumer goods;

(3) The conflicting interest is a lien on the real property obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this article; or

(4) The security interest is:

(A) Created in a manufactured home in a manufactured-home transaction; and

(B) Perfected pursuant to a statute described in section 4-9-311 (a) (2).

(f) A security interest in fixtures, whether or not perfected, has priority over a conflicting interest of an encumbrancer or owner of the real property if:

(1) The encumbrancer or owner has, in an authenticated record, consented to the security interest or disclaimed an interest in the goods as fixtures; or

(2) The debtor has a right to remove the goods as against the encumbrancer or owner.

(g) The priority of the security interest under paragraph (2) of subsection (f) of this section continues for a reasonable time if the debtor's right to remove the goods as against the encumbrancer or owner terminates.

(h) A mortgage is a construction mortgage to the extent that it secures an obligation incurred for the construction of an improvement on land, including the acquisition cost of the land, if a recorded record of the mortgage so indicates. Except as otherwise provided in subsections (e) and (f) of this section, a security interest in fixtures is subordinate to a construction mortgage if a record of the mortgage is recorded before the goods become fixtures and the goods become fixtures before the completion of the construction. A mortgage has this priority to the same extent as a construction mortgage to the extent that it is given to refinance a construction mortgage.

(i) A perfected security interest in crops growing on real property has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property.

Source: L. 2001: Entire article R&RE, p. 1366, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-313 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-313.

2. **Scope of This Section.** This section contains rules governing the priority of security interests in fixtures and crops as against persons who claim an interest in real property. Priority contests with other Article 9 security interests are governed by the other priority rules of this Article. The provisions with respect to fixtures follow those of former Section 9-313. However, they have been rewritten to conform to Section 2A-309 and to prevailing style conventions. Subsections (i) and (j), which apply to crops, are new.

3. **Security Interests in Fixtures.** Certain goods that are the subject of personal-property (chattel) financing become so affixed or otherwise so related to real property that they become part of the real property. These goods are called "fixtures." See Section 9-102 (definition of "fixtures"). Some fixtures retain their personal-property nature: a security interest under this Article may be created in fixtures and may continue in goods that become fixtures. See subsection (a). However, if the goods are ordinary building materials incorporated into an improvement on land, no security interest in them exists. Rather, the priority of claims to the building materials are determined by the law governing claims to real property. (Of course, the fact that no security interest exists in ordinary building materials incorporated into an improvement on land does not prejudice any rights the secured party may have against the debtor or any other person who violated the secured party's rights by wrongfully incorporating the goods into real property.)

Thus, this section recognizes three categories of goods: (1) those that retain their chattel character entirely and are not part of the real property; (2) ordinary building materials that have become an integral part of the real property and cannot retain their chattel character for purposes of finance; and (3) an intermediate class that has become real property for certain purposes, but as to which chattel financing may be preserved.

To achieve priority under certain provisions of this section, a security interest must be perfected by making a "fixture filing" (defined in Section 9-102) in the real-property records. Because the question whether goods have become fixtures often is a difficult one under applicable real-property law, a secured party may make a fixture filing as a precaution. Courts should not infer from a fixture filing that the secured party concedes that the goods are or will become fixtures.

4. **Priority in Fixtures: General.** In considering priority problems under this section, one must first determine whether real-property claimants per se have an interest in the crops or fixtures as part of real property. If not, it is immaterial, so far as concerns real property parties as such, whether a security interest arising under this Article is perfected or unperfected. In no event does a real-property claimant (e.g., owner or mortgagee) acquire an interest in a "pure" chattel just because a security interest therein is unperfected. If on the other hand real-property law gives real-property parties an interest in the goods, a conflict arises and this section states the priorities.

5. **Priority in Fixtures: Residual Rule.** Subsection (c) states the residual priority rule, which applies only if one of the other rules does not: A security interest in fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real property other than the debtor.

6. **Priority in Fixtures: First to File or Record.** Subsection (e)(1), which follows former Section 9-313(4)(b), contains the usual priority rule of conveyancing, that is, the first to file or record prevails. In order to achieve priority under this rule, however, the security interest must be perfected by a "fixture filing" (defined in Section 9-102), i.e., a filing for record in the real property records and indexed therein, so that it will be found in a real-property search.. The condition in subsection (e)(1)(B), that the security interest must have had priority over any conflicting interest of a predecessor in title of the conflicting encumbrancer or owner, appears to limit to the first-in-time principle. However, this apparent limitation is nothing other than an expression of the usual rule that a person must be entitled to transfer what he has. Thus, if the fixture security interest is subordinate to a mortgage, it is subordinate to an interest of an assignee of the mortgage, even though the assignment is a later recorded instrument. Similarly if the fixture security interest is subordinate to the rights of an owner, it is subordinate to a subsequent grantee of the owner and likewise subordinate to a subsequent mortgagee of the owner.

7. **Priority in Fixtures: Purchase-Money Security Interests.** Subsection (d), which follows former Section 9-313(4)(a), contains the principal exception to the first-to-file-or-record rule of subsection (e)(1). It affords priority to purchase-money security interests in fixtures as against *prior* recorded real-property interests, provided that the purchase-money security interest is filed as a fixture filing in the real-property records before the goods become fixtures or within 20 days thereafter. This priority corresponds to the purchase-money priority under Section 9-324(a). (Like other 10-day periods in former Article 9, the 10-day period in this section has been changed to 20 days.)

It should be emphasized that this purchase-money priority with the 20-day grace period for filing is limited to rights against real-property interests that arise *before* the goods become

fixtures. There is no such priority with the 20-day grace period as against real-property interests that arise subsequently. The fixture security interest can defeat subsequent real-property interests only if it is filed first and prevails under the usual conveyancing rule in subsection (e)(1) or one of the other rules in this section.

8. **Priority in Fixtures: Readily Removable Goods.** Subsection (e)(2), which derives from Section 2A-309 and former Section 9-313(4)(d), contains another exception to the usual first-to-file-or-perfect rule. It affords priority to the holders of security interests in certain types of readily removable goods factory and office machines, equipment that is not primarily used or leased for use in the operation of the real property, and (as discussed below) certain replacements of domestic appliances. This rule is made necessary by the confusion in the law as to whether certain machinery, equipment, and appliances become fixtures. It protects a secured party who, perhaps in the mistaken belief that the readily removable goods will not become fixtures, makes a UCC filing (or otherwise perfects under this Article) rather than making a fixture filing.

Frequently, under applicable law, goods of the type described in subsection (e)(2) will not be considered to have become part of the real property. In those cases, the fixture security interest does not conflict with a real-property interest, and resort to this section is unnecessary. However, if the goods have become part of the real property, subsection (e)(2) enables a fixture secured party to take priority over a conflicting real-property interest if the fixture security interest is perfected by a fixture filing or by any other method permitted by this Article. If perfection is by fixture filing, the fixture security interest would have priority over subsequently recorded real-property interests under subsection (e)(1) and, if the fixture security interest is a purchase-money security interest (a likely scenario), it would also have priority over most real property interests under the purchase-money priority of subsection (d). Note, however, that unlike the purchase-money priority rule in subsection (d), the priority rules in subsection (e) override the priority given to a construction mortgage under subsection (h).

The rule in subsection (e)(2) is limited to readily removable replacements of domestic appliances. It does not apply to original installations. Moreover, it is limited to appliances that are "consumer goods" (defined in Section 9-102) in the hands of the debtor. The principal effect of the rule is to make clear that a secured party financing occasional replacements of domestic appliances in noncommercial, owner-occupied contexts need not concern itself with real-property descriptions or records; indeed, for a purchase-money replacement of consumer goods, perfection without any filing will be possible. See Section 9-309(1).

9. **Priority in Fixtures: Judicial Liens.** Subsection (e)(3), which follows former Section 9-313(4)(d), adopts a first-in-time rule applicable to conflicts between a fixture security interest and a lien on the real property obtained by legal or equitable proceedings. Such a lien is subordinate to an earlier-perfected security interest, regardless of the method by which the security interest was perfected. Judgment creditors generally are not reliance creditors who search real-property records. Accordingly, a perfected fixture security interest takes priority over a subsequent judgment lien or other lien obtained by legal or equitable proceedings, even if no evidence of the security interest appears in the relevant real-property records. Subsection (e)(3) thus protects a perfected fixture security interest from avoidance by a trustee in bankruptcy under Bankruptcy Code Section 544(a), regardless of the method of perfection.

10. **Priority in Fixtures: Manufactured Homes.** A manufactured home may become a fixture. New subsection (e)(4) contains a special rule granting priority to certain security interests created in a "manufactured home" as part of a "manufactured-home transaction" (both defined in Section 9-102). Under this rule, a security interest in a manufactured home that becomes a fixture has priority over a conflicting interest of an encumbrancer or owner of the real property if the security interest is perfected under a certificate-of-title statute (see Section 9-311). Subsection (e)(4) is only one of the priority rules applicable to security interests in a manufactured home that becomes a fixture. Thus, a security interest in a manufactured home which does not qualify for priority under this subsection may qualify under another.

11. **Priority in Fixtures: Construction Mortgages.** The purchase-money priority presents a difficult problem in relation to construction mortgages. The latter ordinarily will have been recorded even before the commencement of delivery of materials to the job, and therefore would take priority over fixture security interests were it not for the purchase-money priority. However, having recorded first, the holder of a construction mortgage reasonably expects to have first priority in the improvement built using the mortgagee's advances. Subsection (g) expressly gives priority to the construction mortgage recorded before the filing of the purchase-money security interest in fixtures. A refinancing of a construction mortgage has the same priority as the construction mortgage itself. The phrase "an obligation incurred for the construction of an improvement" covers both optional advances and advances pursuant to commitment. Both types of advances have the same priority under subsection (g).

The priority under this subsection applies only to goods that become fixtures during the construction period leading to the completion of the improvement. The construction priority will not apply to additions to the building made long after completion of the improvement, even if the additions are financed by the real-property mortgagee under an open-end clause of the construction mortgage. In such case, subsections (d), (e), and (f) govern.

Although this subsection affords a construction mortgage priority over a purchase- money security interest that otherwise would have priority under subsection (d), the subsection is subject to the priority rules in subsections (e) and (f). Thus, a construction mortgage may be junior to a fixture security interest perfected by a fixture filing before the construction mortgage was recorded. See subsection (e)(1).

12. **Crops.** Growing crops are "goods" in which a security interest may be created and perfected under this Article. In some jurisdictions, a mortgage of real property may cover crops, as well. In the event that crops are encumbered by both a mortgage and an Article 9 security interest, subsection (i) provides that the security interest has priority. States whose real-property law provides otherwise should either amend that law directly or override it by enacting subsection (j).

ANNOTATION

Law reviews. For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

Annotator's note. Since § 4-9-334 is similar to § 4-9-313 as it existed prior to the 2001 repeal and reenactment of this article, a relevant case construing that provision has been included in the annotations to this section.

Filing under this section not required in the case of manufactured ("mobile") homes if requirements of § 38-29-125 are met. Where creditor noted its lien on certificate of title pursuant to section of Colorado "Titles to Manufactured Homes Act", article 29 of title 38, C.R.S., and home was not held as inventory, creditor's interest was superior to that of holder of trust deed to real estate on which home had been affixed although creditor had not made a "fixture filing" under this section. ENT Federal Credit Union v. Chrysler First Financial Serv. Corp., 826 P.2d 430 (Colo. App. 1992).

4-9-335. Accessions. (a) A security interest may be created in an accession and continues in collateral that becomes an accession.

(b) If a security interest is perfected when the collateral becomes an accession, the security interest remains perfected in the collateral.

(c) Except as otherwise provided in subsection (d) of this section, the other provisions of this part 3 determine the priority of a security interest in an accession.

(d) A security interest in an accession is subordinate to a security interest in the whole which is perfected by compliance with the requirements of a certificate-of-title statute under section 4-9-311 (b).

(e) After default, subject to part 6 of this article, a secured party may remove an accession from other goods if the security interest in the accession has priority over the claims of every person having an interest in the whole.

(f) A secured party that removes an accession from other goods under subsection (e) of this section shall promptly reimburse any holder of a security interest or other lien on, or owner of, the whole or of the other goods, other than the debtor, for the cost of repair of any physical injury to the whole or the other goods. The secured party need not reimburse the holder or owner for any diminution in value of the whole or the other goods caused by the absence of the accession removed or by any necessity for replacing it. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation to reimburse.

Source: L. 2001: Entire article R&RE, p. 1368, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** Former Section 9-314.

2. **"Accession."** This section applies to an "accession," as defined in Section 9-102, regardless of the cost or difficulty of removing the accession from the other goods, and regardless of whether the original goods have come to form an integral part of the other goods. This section does not apply to goods whose identity has been

lost. Goods of that kind are "commingled goods" governed by Section 9-336. Neither this section nor the following one addresses the case of collateral that changes form without the addition of other goods.

3. **"Accession" vs. "Other Goods."** This section distinguishes among the "accession," the "other goods," and the "whole." The last term refers to the combination of the "accession" and the "other goods." If one person's collateral becomes physically united with another person's collateral, each is an "accession."

Example 1: SP-1 holds a security interest in the debtor's tractors (which are not subject to a certificate-of-title statute), and SP-2 holds a security interest in a particular tractor engine. The engine is installed in a tractor. From the perspective of SP-1, the tractor becomes an "accession" and the engine is the "other goods." From the perspective of SP-2, the engine is the "accession" and the tractor is the "other goods." The completed tractor tractor cum engine constitutes the "whole."

4. **Scope.** This section governs only a few issues concerning accessions. Subsection (a) contains rules governing continuation of a security interest in an accession. Subsection (b) contains a rule governing continued perfection of a security interest in goods that become an accession. Subsection (d) contains a special priority rule governing accessions that become part of a whole covered by a certificate of title. Subsections (e) and (f) govern enforcement of a security interest in an accession.

5. **Matters Left to Other Provisions of This Article: Attachment and Perfection.** Other provisions of this Article often govern accession-related issues. For example, this section does not address whether a secured party acquires a security interest in the whole if its collateral becomes an accession. Normally this will turn on the description of the collateral in the security agreement.

Example 2: Debtor owns a computer subject to a perfected security interest in favor of SP-1. Debtor acquires memory and installs it in the computer. Whether SP-1's security interest attaches to the memory depends on whether the security agreement covers it.

Similarly, this section does not determine whether perfection against collateral that becomes an accession is effective to perfect a security interest in the whole. Other provisions of this Article, including the requirements for indicating the collateral covered by a financing statement, resolve that question.

6. **Matters Left to Other Provisions of This Article: Priority.** With one exception, concerning goods covered by a certificate of title (see subsection (d)), the other provisions of this Part, including the rules governing purchase-money security interests, determine the priority of most security interests in an accession, including the relative priority of a security interest in an accession and a security interest in the whole. See subsection (c).

Example 3: Debtor owns an office computer subject to a security interest in favor of SP-1. Debtor acquires memory and grants a perfected security interest in the memory to SP-2. Debtor installs the memory in the computer, at which time (one assumes) SP-1's security interest attaches to the memory. The first-to-file-or-perfect rule of Section 9-322 governs priority in the memory. If, however, SP-2's security interest is a purchase-money security interest, Section 9-324(a) would afford priority in the memory to SP-2, regardless of which security interest was perfected first.

7. **Goods Covered by Certificate of Title.** This section does govern the priority of a security interest in an accession that is or becomes part of a whole that is subject to a security interest perfected by compliance with a certificate-of-title statute. Subsection (d) provides that a security interest in the whole, perfected by compliance with a certificate-of-title statute, takes priority over a security interest in the accession. It enables a secured party to rely upon a certificate of title without having to check the UCC files to determine whether any components of the collateral may be encumbered. The subsection imposes a corresponding risk upon those who finance goods that may become part of goods covered by a certificate of title. In doing so, it reverses the priority that appeared reasonable to most pre-UCC courts.

Example 4: Debtor owns an automobile subject to a security interest in favor of SP-1. The security interest is perfected by notation on the certificate of title. Debtor buys tires subject to a perfected-by-filing purchase-money security interest in favor of SP-2 and mounts the tires on the automobile's wheels. If the security interest in the automobile attaches to the tires, then SP-1 acquires priority over SP-2. The same result would obtain if SP-1's security interest attached to the automobile and was perfected after the tires had been mounted on the wheels.

4-9-336. Commingled goods. (a) In this section, "commingled goods" means goods that are physically united with other goods in such a manner that their identity is lost in a product or mass.

(b) A security interest does not exist in commingled goods as such. However, a security interest may attach to a product or mass that results when goods become commingled goods.

(c) If collateral becomes commingled goods, a security interest attaches to the product or mass.

(d) If a security interest in collateral is perfected before the collateral becomes commingled goods, the security interest that attaches to the product or mass under subsection (c) of this section is perfected.

(e) Except as otherwise provided in subsection (f) of this section, the other provisions of this part 3 determine the priority of a security interest that attaches to the product or mass under subsection (c) of this section.

(f) If more than one security interest attaches to the product or mass under subsection (c) of this section, the following rules determine priority:

(1) A security interest that is perfected under subsection (d) of this section has priority over a security interest that is unperfected at the time the collateral becomes commingled goods.

(2) If more than one security interest is perfected under subsection (d) of this section, the security interests rank equally in proportion to the value of the collateral at the time it became commingled goods.

Source: L. 2001: Entire article R&RE, p. 1368, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** Former Section 9-315.

2. **"Commingled Goods."** Subsection (a) defines "commingled goods." It is meant to include not only goods whose identity is lost through manufacturing or production (e.g., flour that has become part of baked goods) but also goods whose identity is lost by commingling with other goods from which they cannot be distinguished (e.g., ball bearings).

3. **Consequences of Becoming "Commingled Goods."** By definition, the identity of the original collateral cannot be determined once the original collateral becomes commingled goods. Consequently, the security interest in the specific original collateral alone is lost once the collateral becomes commingled goods, and no security interest in the original collateral can be created thereafter except as a part of the resulting product or mass. See subsection (b).

Once collateral becomes commingled goods, the secured party's security interest is transferred from the original collateral to the product or mass. See subsection (c). If the security interest in the original collateral was perfected, the security interest in the product or mass is a perfected security interest. See subsection (d). This perfection continues until lapse.

4. **Priority of Perfected Security Interests That Attach Under This Section.** This section governs the priority of competing security interests in a product or mass only when both security interests arise under this section. In that case, if both security interests are perfected by operation of this section (see subsections (c) and (d)), then the security interests rank equally, in proportion to the value of the collateral at the time it became commingled goods. See subsection (f)(2).

Example 1: SP-1 has a perfected security interest in Debtor's eggs, which have a value of $300 and secure a debt of $400, and SP-2 has a perfected security interest in Debtor's flour, which has a value of $500 and secures a debt of $700. Debtor uses the flour and eggs to make cakes, which have a value of $1000. The two security interests rank equally and share in the ratio of 3:5. Applying this ratio to the entire value of the product, SP-1 would be entitled to $375 (i.e., 3/8 x $1000), and SP-2 would be entitled to $625 (i.e., 5/8 x $1000).

Example 2: Assume the facts of Example 1, except that SP-1's collateral, worth $300, secures a debt of $200. Recall that, if the cake is worth $1000, then applying the ratio of 3:5 would entitle SP-1 to $375 and SP-2 to $625. However, SP-1 is not entitled to collect from the product more than it is owed. Accordingly, SP-1's share would be only $200, SP-2 would receive the remaining value, up to the amount it is owed ($700).

Example 3: Assume that the cakes in the previous examples have a value of only $600. Again, the parties share in the ratio of 3:5. If, as in Example 1, SP-1 is owed $400, then SP-1 is entitled to $225 (i.e., 3/8 x $600), and SP-2 is entitled to $375 (i.e., 5/8 x $600). Debtor receives nothing. If, however, as in Example 2, SP-1 is owed only $200, then SP-2 receives $400.

The results in the foregoing examples remain the same, regardless of whether SP-1 or SP-2 (or each) has a purchase-money security interest.

5. **Perfection: Unperfected Security Interests.** The rule explained in the preceding Comment applies only when both security interests in original collateral are perfected when the goods become commingled goods. If a security interest in original collateral is unperfected at the time the collateral becomes commingled goods, subsection (f)(1) applies.

Example 4: SP-1 has a perfected security interest in the debtor's eggs, and SP-2 has an unperfected security interest in the debtor's flour. Debtor uses the flour and eggs to make cakes. Under subsection (c), both security interests attach to the cakes. But since SP-1's security interest was perfected at the time of commingling and SP-2's was not, only SP-1's security interest in the cakes is perfected. See subsection (d). Under subsection (f)(1) and Section 9-322(a)(2), SP-1's perfected security interest has priority over SP-2's unperfected security interest.

If both security interests are unperfected, the rule of Section 9-322(a)(3) would apply.

6. **Multiple Security Interests.** On occasion, a single input may be encumbered by more than one security interest. In those cases, the multiple secured parties should be treated like a single secured party for purposes of determining their collective share under subsection (f)(2). The normal priority rules would determine how that share would be allocated between them. Consider the following example, which is a variation on Example 1 above:

Example 5: SP-1A has a perfected, first-priority security interest in Debtor's eggs. SP-1B has a perfected, second-priority security interest in the same collateral. The eggs have a value of $300. Debtor owes $200 to SP-1A and $200 to SP-1B. SP-2 has a perfected security interest in Debtor's flour, which has a value of $500 and secures a debt of $600. Debtor uses the flour and eggs to make cakes, which have a value of $1000.

For purposes of subsection (f)(2), SP-1A and SP-1B should be treated like a single secured party. The collective security interest would rank equally with that of SP-2. Thus, the secured parties would share in the ratio of 3 (for SP-1A and SP-1B combined) to 5 (for SP-2). Applying this ratio to the entire value of the product, SP-1A and SP-1B in the aggregate would be entitled to $375 (i.e., 3/8 x $1000), and SP-2 would be entitled to $625 (i.e., 5/8 x $1000).

SP-1A and SP-1B would share the $375 in accordance with their priority, as established under other rules. Inasmuch as SP-1A has first priority, it would receive $200, and SP-1B would receive $175.

7. **Priority of Security Interests That Attach Other Than by Operation of This Section.** Under subsection (e), the normal priority rules determine the priority of a security interest that attaches to the product or mass other than by operation of this section. For example, assume that SP-1 has a perfected security interest in Debtor's existing and after-acquired baked goods, and SP-2 has a perfected security interest in Debtor's flour. When the flour is processed into cakes, subsections (c) and (d) provide that SP-2 acquires a perfected security interest in the cakes. If SP-1 filed against the baked goods before SP-2 filed against the flour, then SP-1 will enjoy priority in the cakes. See Section 9-322 (first-to-file-or-perfect). But if SP-2 filed against the flour before SP-1 filed against the baked goods, then SP-2 will enjoy priority in the cakes to the extent of its security interest.

4-9-337. Priority of security interests in goods covered by certificate of title. If, while a security interest in goods is perfected by any method under the law of another jurisdiction, this state issues a certificate of title that does not show that the goods are subject to the security interest or contain a statement that they may be subject to security interests not shown on the certificate:

(1) A buyer of the goods, other than a person in the business of selling goods of that kind, takes free of the security interest if the buyer gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest; and

(2) The security interest is subordinate to a conflicting security interest in the goods that attaches, and is perfected under section 4-9-311 (b), after issuance of the certificate and without the conflicting secured party's knowledge of the security interest.

Source: L. 2001: Entire article R&RE, p. 1369, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** Derived from former Section 9-103(2)(d).

2. **Protection for Buyers and Secured Parties.** This section affords protection to certain good-faith purchasers for value who are likely to have relied on a "clean" certificate of title, i.e., one that neither shows that the goods are subject to a particular security interest nor contains a statement that they may be subject to security interests not shown on the certificate. Under this section, a buyer can take free of, and the holder of a conflicting security interest can acquire priority over, a security interest that is perfected by any method under the law of another jurisdiction. The fact that the security interest has been reperfected by possession under Section

9-313 does not of itself disqualify the holder of a conflicting security interest from protection under paragraph (2).

4-9-338. Priority of security interest or agricultural lien perfected by filed financing statement providing certain incorrect information. If a security interest or agricultural lien is perfected by a filed financing statement providing information described in section 4-9-516 (b) (5) which is incorrect at the time the financing statement is filed:

(1) The security interest or agricultural lien is subordinate to a conflicting perfected security interest in the collateral to the extent that the holder of the conflicting security interest gives value in reasonable reliance upon the incorrect information; and

(2) A purchaser, other than a secured party, of the collateral takes free of the security interest or agricultural lien to the extent that, in reasonable reliance upon the incorrect information, the purchaser gives value and, in the case of tangible chattel paper, tangible documents, goods, instruments, or a security certificate, receives delivery of the collateral.

Source: L. 2001: Entire article R&RE, p. 1369, § 1, effective July 1. **L. 2006:** (2) amended, p. 502, § 43, effective September 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Effect of Incorrect Information in Financing Statement.** Section 9-520(a) requires the filing office to reject financing statements that do not contain information concerning the debtor as specified in Section 9-516(b)(5). An error in this information does not render the financing statement ineffective. On rare occasions, a subsequent purchaser of the collateral (i.e., a buyer or secured party) may rely on the misinformation to its detriment. This section subordinates a security interest or agricultural lien perfected by an effective, but flawed, financing statement to the rights of a buyer or holder of a perfected security interest to the extent that, in reasonable reliance on the incorrect information, the purchaser gives value and, in the case of tangible collateral, receives delivery of the collateral. A purchaser who has not made itself aware of the information in the filing office with respect to the debtor cannot act in "reasonable reliance" upon incorrect information.

3. **Relationship to Section 9-507.** This section applies to financing statements that contain information that is incorrect at the time of filing and imposes a small risk of subordination on the filer. In contrast, Section 9-507 deals with financing statements containing information that is correct at the time of filing but which becomes incorrect later. Except as provided in Section 9-507 with respect to changes in the debtor's name [that is sufficient as the name of the debtor under Section 9-503 (a),] an otherwise effective financing statement does not become ineffective if the information contained in it becomes inaccurate.

Note: In the third sentence, "debtor's" will be deleted effective July 1, 2013, and the bracketed language takes effect July 1, 2013.

4-9-339. Priority subject to subordination. This article does not preclude subordination by agreement by a person entitled to priority.

Source: L. 2001: Entire article R&RE, p. 1370, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-316 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-316.

2. **Subordination by Agreement.** The preceding sections deal elaborately with questions of priority. This section makes it entirely clear that a person entitled to priority may effectively agree to subordinate its claim. Only the person entitled to priority may make such an agreement: a person's rights cannot be adversely affected by an agreement to which the person is not a party.

4-9-340. Effectiveness of right of recoupment or set-off against deposit account. (a) Except as otherwise provided in subsection (c) of this section, a bank with which a deposit account is maintained may exercise any right of recoupment or set-off against a secured party that holds a security interest in the deposit account.

(b) Except as otherwise provided in subsection (c) of this section, the application of this article to a security interest in a deposit account does not affect a right of recoupment or set-off of the secured party as to a deposit account maintained with the secured party.

(c) The exercise by a bank of a set-off against a deposit account is ineffective against a secured party that holds a security interest in the deposit account which is perfected by control under section 4-9-104 (a) (3), if the set-off is based on a claim against the debtor.

Source: L. 2001: Entire article R&RE, p. 1370, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New; subsection (b) is based on a nonuniform Illinois amendment.

2. **Set-off vs. Security Interest.** This section resolves the conflict between a security interest in a deposit account and the bank's rights of recoupment and set-off.

Subsection (a) states the general rule and provides that the bank may effectively exercise rights of recoupment and set-off against the secured party. Subsection (c) contains an exception: if the secured party has control under Section 9-104(a)(3) (i.e., if it has become the bank's customer), then any set-off exercised by the bank against a debt owed by the debtor (as opposed to a debt owed to the bank by the secured party) is ineffective. The bank may, however, exercise its recoupment rights effectively. This result is consistent with the priority rule in Section 9-327(4), under which the security interest of a bank in a deposit account is subordinate to that of a secured party who has control under Section 9-104(a)(3).

This section deals with rights of set-off and recoupment that a bank may have under other law. It does not create a right of set-off or recoupment, nor is it intended to override any limitations or restrictions that other law imposes on the exercise of those rights.

3. **Preservation of Set-Off Right.** Subsection (b) makes clear that a bank may hold both a right of set-off against, and an Article 9 security interest in, the same deposit account. By holding a security interest in a deposit account, a bank does not impair any right of set-off it would otherwise enjoy. This subsection does not pertain to accounts evidenced by an instrument (e.g., certain certificates of deposit), which are excluded from the definition of "deposit accounts."

4-9-341. Bank's rights and duties with respect to deposit account. Except as otherwise provided in section 4-9-340 (c), and unless the bank otherwise agrees in an authenticated record, a bank's rights and duties with respect to a deposit account maintained with the bank are not terminated, suspended, or modified by:

(1) The creation, attachment, or perfection of a security interest in the deposit account;

(2) The bank's knowledge of the security interest; or

(3) The bank's receipt of instructions from the secured party.

Source: L. 2001: Entire article R&RE, p. 1370, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Free Flow of Funds.** This section is designed to prevent security interests in deposit accounts from impeding the free flow of funds through the payment system. Subject to two exceptions, it leaves the bank's rights and duties with respect to the deposit account and the funds on deposit unaffected by the creation or perfection of a security interest or by the bank's knowledge of the security interest. In addition, the section permits the bank to ignore the instructions of the secured party unless it had agreed to honor them or unless other law provides to the contrary. A secured party who wishes to deprive the debtor of access to funds on deposit or to appropriate those funds for itself needs to obtain the agreement of the bank, utilize the judicial process, or comply with procedures set forth in other law. Section 4-303(a), concerning the effect of notice on a bank's right and duty to pay items, is not to the contrary. That section addresses only whether an otherwise

effective notice comes too late; it does not determine whether a timely notice is otherwise effective.

3. **Operation of Rule.** The general rule of this section is subject to Section 9-340(c), under which a bank's right of set-off may not be exercised against a deposit account in the secured party's name if the right is based on a claim against the debtor. This result reflects current law in many jurisdictions and does not appear to have unduly disrupted banking practices or the payments system. The more important function of this section, which is not impaired by Section 9-340, is the bank's right to follow the debtor's (customer's) instructions (e.g., by honoring checks, permitting withdrawals, etc.) until such time as the depository institution is served with judicial process or receives instructions with respect to the funds on deposit from a secured party who has control over the deposit account.

4. **Liability of Bank.** This Article does not determine whether a bank that pays out funds from an encumbered deposit is liable to the holder of a security interest. Although the fact that a secured party has control over the deposit account and the manner by which control was achieved may be relevant to the imposition of liability, whatever rule applies generally when a bank pays out funds in which a third party has an interest would determine liability to a secured party. Often, this rule is found in a non-UCC adverse claim statute.

5. **Certificates of Deposit.** This section does not address the obligations of banks that issue instruments evidencing deposits (e.g., certain certificates of deposit).

4-9-342. Bank's right to refuse to enter into or disclose existence of control agreement. This article does not require a bank to enter into an agreement of the kind described in section 4-9-104 (a) (2), even if its customer so requests or directs. A bank that has entered into such an agreement is not required to confirm the existence of the agreement to another person unless requested to do so by its customer.

Source: L. 2001: Entire article R&RE, p. 1370, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New; derived from Section 8-106(g).

2. **Protection for Bank.** This section protects banks from the need to enter into agreements against their will and from the need to respond to inquiries from persons other than their customers.

PART 4

RIGHTS OF THIRD PARTIES

4-9-401. Alienability of debtor's rights. (a) Except as otherwise provided in subsection (b) of this section and sections 4-9-406, 4-9-407, 4-9-408, and 4-9-409, whether a debtor's rights in collateral may be voluntarily or involuntarily transferred is governed by law other than this article.

(b) An agreement between the debtor and secured party which prohibits a transfer of the debtor's rights in collateral or makes the transfer a default does not prevent the transfer from taking effect.

(c) This section shall not be construed as being inconsistent with criminal sanctions now or hereafter applicable to transactions involving collateral or as justifying any transfer that would otherwise be a violation of law.

Source: L. 2001: Entire article R&RE, p. 1371, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-311 as it existed prior to 2001.
(2) **Colorado legislative change:** Colorado added subsection (c).

OFFICIAL COMMENT

1. **Source.** Former Section 9-311.

2. **Scope of This Part.** This Part deals with several issues affecting third parties (i.e., parties other than the debtor and the secured party). These issues are not addressed in Part 3, Subpart 3, which deals with priorities. This Part primarily addresses the rights and duties of account debtors and other persons obligated on collateral who are not, themselves, parties to a secured transaction.

3. **Governing Law.** There was some uncertainty under former Article 9 as to which jurisdiction's law (usually, which jurisdiction's version of Article 9) applied to the matters that this Part addresses. Part 3, Subpart 1, does not determine the law governing these matters because they do not relate to perfection, the effect of perfection or nonperfection, or priority. However, it might be inappropriate for a designation of applicable law by a debtor and secured party under Section 1-105 to control the law applicable to an independent transaction or relationship between the debtor and an account debtor.

Note: "1-105" in the third sentence will be replaced with "1-301" effective July 1, 2013.

Consider an example under Section 9-408.

Example 1: State X has adopted this Article; former Article 9 is the law of State Y. A general intangible (e.g., a franchise agreement) between a debtor-franchisee, D, and an account debtor-franchisor, AD, is governed by the law of State Y. D grants to SP a security interest in its rights under the franchise agreement. The franchise agreement contains a term prohibiting D's assignment of its rights under the agreement. D and SP agree that their secured transaction is governed by the law of State X. Under State X's Section 9-408, the restriction on D's assignment is ineffective to prevent the creation, attachment, or perfection of SP's security interest. State Y's former Section 9-318(4), however, does not address restrictions on the creation of security interests in general intangibles other than general intangibles for money due or to become due. Accordingly, it does not address restrictions on the assignment to SP of D's rights under the franchise agreement. The non-Article-9 law of State Y, which does address restrictions, provides that the prohibition on assignment is effective.

This Article does not provide a specific answer to the question of which State's law applies to the restriction on assignment in the example. However, assuming that under non-UCC choice-of-law principles the effectiveness of the restriction would be governed by the law of State Y, which governs the franchise agreement, the fact that State X's Article 9 governs the secured transaction between SP and D would not override the otherwise applicable law governing the agreement. Of course, to the extent that jurisdictions eventually adopt identical versions of this Article and courts interpret it consistently, the inability to identify the applicable law in circumstances such as those in the example may be inconsequential.

4. **Inalienability Under Other Law.** Subsection (a) addresses the question whether property necessarily is transferable by virtue of its inclusion (i.e., its eligibility as collateral) within the scope of Article 9. It gives a negative answer, subject to the identified exceptions. The substance of subsection (a) was implicit under former Article 9.

5. **Negative Pledge Covenant.** Subsection (b) is an exception to the general rule in subsection (a). It makes clear that in secured transactions under this Article the debtor has rights in collateral (whether legal title or equitable) which it can transfer and which its creditors can reach. It is best explained with an example.

Example 2: A debtor, D, grants to SP a security interest to secure a debt in excess of the value of the collateral. D agrees with SP that it will not create a subsequent security interest in the collateral and that any security interest purportedly granted in violation of the agreement will be void. Subsequently, in violation of its agreement with SP, D purports to grant a security interest in the same collateral to another secured party.

Subsection (b) validates D's creation of the subsequent (prohibited) security interest, which might even achieve priority over the earlier security interest. See Comment 7. However, unlike some other provisions of this Part, such as Section 9-406, subsection (b) does not provide that the agreement restricting assignment itself is "ineffective." Consequently, the debtor's breach may create a default.

6. **Rights of Lien Creditors.** Difficult problems may arise with respect to attachment, levy, and other judicial procedures under which a debtor's creditors may reach collateral subject to a security interest. For example, an obligation may be secured by collateral worth many times the amount of the obligation. If a lien creditor has caused all or a portion of the collateral to be seized under judicial process, it may be difficult to determine the amount of the debtor's "equity" in the collateral that has been seized. The section leaves resolution of this problem to the courts. The doctrine of marshaling may be appropriate.

7. **Sale of Receivables.** If a debtor sells an account, chattel paper, payment intangible, or promissory note outright, as against the buyer the debtor has no remaining rights to transfer. If, however, the buyer fails to perfect its interest, then solely insofar as the rights of certain third parties are concerned, the debtor is deemed to retain its rights and title. See Section 9-318. The

debtor has the power to convey these rights to a subsequent purchaser. If the subsequent purchaser (buyer or secured lender) perfects its interest, it will achieve priority over the earlier, unperfected purchaser. See Section 9-322(a)(1).

ANNOTATION

Law reviews. For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75).

Annotator's note. Since § 4-9-401 is similar to § 4-9-311 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Section does not invalidate prior security interest. This section authorizes the physical transfer of collateral, but does not invalidate any prior security interest. Where the transfer is without the secured party's consent, and is a default under the agreement, the secured party can at that time call the note and take possession of the collateral. Layne v. Fort Carson Nat'l Bank, 655 P.2d 856 (Colo. App. 1982).

Section 4-9-306 and this section must be read together. This section does not invalidate the prior security interest under § 4-9-306 (2). Am. Heritage Bank & Trust Co. v. O. & E., Inc., 40 Colo. App. 306, 576 P.2d 566 (1978).

Bank's interest in collateral is not terminated by failure to participate in garnishment action, and its security interest follows the collateral. El Paso County Bank v. Charles R. Milisen & Co., 622 P.2d 594 (Colo. App. 1980).

4-9-402. Secured party not obligated on contract of debtor or in tort. The existence of a security interest, agricultural lien, or authority given to a debtor to dispose of or use collateral, without more, does not subject a secured party to liability in contract or tort for the debtor's acts or omissions.

Source: L. 2001: Entire article R&RE, p. 1371, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-317 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-317.
2. **Nonliability of Secured Party.** This section, like former Section 9-317, rejects theories on which a secured party might be held liable on a debtor's contracts or in tort merely because a security interest exists or because the debtor is entitled to dispose of or use collateral. This section expands former Section 9-317 to cover agricultural liens.

ANNOTATION

Annotator's note. Since § 4-9-402 is similar to § 4-9-317 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

An assignee of contract rights is not subject to contract or tort liabilities imposed by a contract on the assignor in the absence of an assumption of such liabilities. Farmers Acceptance Corp. v. DeLozier, 178 Colo. 291, 496 P.2d 1016 (1972).

Liability of purchasers at foreclosure sale. Where there was no evidence that purchasers at a foreclosure sale affirmatively assumed the contractual liabilities of a corporation, the purchasers are not liable for these contractual obligations. Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977).

But where a secured creditor initiates or encourages transactions between a debtor and unsecured creditor who is a supplier of goods or services and the secured creditor benefits from the goods or services supplied, equitable principles require the secured creditor to compensate the unsecured creditor to avoid unjust enrichment, especially where the goods or services supplied are necessary for preserving the secured collateral. Ninth Dist. Prod. Credit v. Ed Duggan, 821 P.2d 788 (Colo. 1991).

Applied in Ninth Dist. Prod. Credit v. Ed Duggan, 821 P.2d 788 (Colo. 1991).

4-9-403. Agreement not to assert defenses against assignee. (a) In this section, "value" has the meaning provided in section 4-3-303 (a).

(b) Except as otherwise provided in this section, an agreement between an account debtor and an assignor not to assert against an assignee any claim or defense that the account debtor may have against the assignor is enforceable by an assignee that takes an assignment:

(1) For value;

(2) In good faith;

(3) Without notice of a claim of a property or possessory right to the property assigned; and

(4) Without notice of a defense or claim in recoupment of the type that may be asserted against a person entitled to enforce a negotiable instrument under section 4-3-305 (a).

(c) Subsection (b) of this section does not apply to defenses of a type that may be asserted against a holder in due course of a negotiable instrument under section 4-3-305 (b).

(d) In a consumer transaction, if a record evidences the account debtor's obligation, law other than this article requires that the record include a statement to the effect that the rights of an assignee are subject to claims or defenses that the account debtor could assert against the original obligee, and the record does not include such a statement:

(1) The record has the same effect as if the record included such a statement; and

(2) The account debtor may assert against an assignee those claims and defenses that would have been available if the record included such a statement.

(e) This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(f) Except as otherwise provided in subsection (d) of this section, this section does not displace law other than this article which gives effect to an agreement by an account debtor not to assert a claim or defense against an assignee.

Source: L. 2001: Entire article R&RE, p. 1371, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-206 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-206.

2. **Scope and Purpose.** Subsection (b), like former Section 9-206, generally validates an agreement between an account debtor and an assignor that the account debtor will not assert against an assignee claims and defenses that it may have against the assignor. These agreements are typical in installment sale agreements and leases. However, this section expands former Section 9-206 to apply to all account debtors; it is not limited to account debtors that have bought or leased goods. This section applies only to the obligations of an "account debtor," as defined in Section 9-102. Thus, it does not determine the circumstances under which and the extent to which a person who is obligated on a negotiable instrument is disabled from asserting claims and defenses. Rather, Article 3 must be consulted. See, e.g., Sections 3-305, 3-306. Article 3 governs even when the negotiable instrument constitutes part of chattel paper. See Section 9-102 (an obligor on a negotiable instrument constituting part of chattel paper is not an "account debtor").

3. **Conditions of Validation; Relationship to Article 3.** Subsection (b) validates an account debtor's agreement only if the assignee takes an assignment for value, in good faith, and without notice of conflicting claims to the property assigned or of certain claims or defenses of the account debtor. Like former Section 9-206, this section is designed to put the assignee in a position that is no better and no worse than that of a holder in due course of a negotiable instrument under Article 3. However, former Section 9-206 left open certain issues, e.g., whether the section incorporated the special Article 3 definition of "value" in Section 3-303 or the generally applicable definition in Section 1-201(44). Subsection (a) addresses this question; it provides that "value" has the meaning specified in Section 3-303(a). Similarly, subsection (c) provides that subsection (b) does not validate an agreement with respect to defenses that could be asserted against a holder in due course under Section 3-305(b) (the so-called "real" defenses). In 1990, the definition of "holder in due course" (Section 3-302) and the articulation of the rights of a holder in due course (Sections 3-305 and 3-306) were revised substantially. This section tracks more closely the rules of Sections 3-302, 3-305, and 3-306.

4. **Relationship to Terms of Assigned Property.** Former Section 9-206(2), concerning war-

ranties accompanying the sale of goods, has been deleted as unnecessary. This Article does not regulate the terms of the account, chattel paper, or general intangible that is assigned, except insofar as the account, chattel paper, or general intangible itself creates a security interest (as often is the case with chattel paper). Thus, Article 2, and not this Article, determines whether a seller of goods makes or effectively disclaims warranties, even if the sale is secured. Similarly, other law, and not this Article, determines the effectiveness of an account debtor's undertaking to pay notwithstanding, and not to assert, any defenses or claims against an assignor e.g., a "hell-or-high- water" provision in the underlying agreement that is assigned. If other law gives effect to this undertaking, then, under principles of *nemo dat*, the undertaking would be enforceable by the assignee (secured party). If other law prevents the assignor from enforcing the undertaking, this section nevertheless might permit the assignee to do so. The right of the assignee to enforce would depend upon whether, under the particular facts, the account debtor's undertaking fairly could be construed as an agreement that falls within the scope of this section and whether the assignee meets the requirements of this section.

5. **Relationship to Federal Trade Commission Rule.** Subsection (d) is new. It applies to rights evidenced by a record that is required to contain, but does not contain, the notice set forth in Federal Trade Commission Rule 433, 16 C.F.R. Part 433 (the "Holder-in-Due-Course Regulations"). Under this subsection, an assignee of such a record takes subject to the consumer account debtor's claims and defenses to the same extent as it would have if the writing had contained the required notice. Thus, subsection (d) effectively renders waiver-of-defense clauses ineffective in the transactions with consumers to which it applies.

6. **Relationship to Other Law.** Like former Section 9-206(1), this section takes no position on the enforceability of waivers of claims and defenses by consumer account debtors, leaving that question to other law. However, the reference to "law other than this article" in subsection (e) encompasses administrative rules and regulations; the reference in former Section 9-206(1) that it replaces ("statute or decision") arguably did not.

This section does not displace other law that gives effect to a non-consumer account debtor's agreement not to assert defenses against an assignee, even if the agreement would not qualify under subsection (b). See subsection (f). It validates, but does not invalidate, agreements made by a non-consumer account debtor. This section also does not displace other law to the extent that the other law permits an assignee, who takes an assignment with notice of a claim of a property or possessory right, a defense, or a claim in recoupment, to enforce an account debtor's agreement not to assert claims and defenses against the assign*or* (e.g., a "hell-or-high-water" agreement). See Comment 4. It also does not displace an assignee's right to assert that an account debtor is estopped from asserting a claim or defense. Nor does this section displace other law with respect to waivers of potential future claims and defenses that are the subject of an agreement between the account debtor and the assign*ee*. Finally, it does not displace Section 1-107, concerning waiver of a breach that allegedly already has occurred.

ANNOTATION

Law reviews. For article, "Exclusion and Modification of Warranty under the U.C.C. — How to Succeed in Business Without Being Liable for Not Really Trying", see 46 Den. L.J. 579 (1969).

4-9-404. Rights acquired by assignee; claims and defenses against assignee. (a) Unless an account debtor has made an enforceable agreement not to assert defenses or claims, and subject to subsections (b) to (e) of this section, the rights of an assignee are subject to:

(1) All terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract; and

(2) Any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.

(b) Subject to subsection (c) of this section and except as otherwise provided in subsection (d) of this section, the claim of an account debtor against an assignor may be asserted against an assignee under subsection (a) of this section only to reduce the amount the account debtor owes.

(c) This section is subject to law other than this article which establishes a different rule

for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(d) In a consumer transaction, if a record evidences the account debtor's obligation, law other than this article requires that the record include a statement to the effect that the account debtor's recovery against an assignee with respect to claims and defenses against the assignor may not exceed amounts paid by the account debtor under the record, and the record does not include such a statement, the extent to which a claim of an account debtor against the assignor may be asserted against an assignee is determined as if the record included such a statement.

(e) This section does not apply to an assignment of a health-care-insurance receivable.

Source: L. 2001: Entire article R&RE, p. 1372, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-318 (1) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-318(1).

2. **Purpose; Rights of Assignee in General.** Subsection (a), like former Section 9- 318(1), provides that an assignee generally takes an assignment subject to defenses and claims of an account debtor. Under subsection (a)(1), if the account debtor's defenses on an assigned claim arise from the transaction that gave rise to the contract with the assignor, it makes no difference whether the defense or claim accrues before or after the account debtor is notified of the assignment. Under subsection (a)(2), the assignee takes subject to other defenses or claims only if they accrue before the account debtor has been notified of the assignment. Of course, an account debtor may waive its right to assert defenses or claims against an assignee under Section 9-403 or other applicable law. Subsection (a) tracks Section 3-305(a)(3) more closely than its predecessor.

3. **Limitation on Affirmative Claims.** Subsection (b) is new. It limits the claim that the account debtor may assert against an assignee. Borrowing from Section 3-305(a)(3) and cases construing former Section 9-318, subsection (b) generally does not afford the account debtor the right to an affirmative recovery from an assignee.

4. **Consumer Account Debtors; Relationship to Federal Trade Commission Rule.** Subsections (c) and (d) also are new. Subsection (c) makes clear that the rules of this section are subject to other law establishing special rules for consumer account debtors. An "account debtor who is an individual" as used in subsection (c) includes individuals who are jointly or jointly and severally obligated. Subsection (d) applies to rights evidenced by a record that is required to contain, but does not contain, the notice set forth in Federal Trade Commission Rule 433, 16 C.F.R. Part 433 (the "Holder-in-Due-Course Regulations"). Under subsection (d), a consumer account debtor has the same right to an affirmative recovery from an assignee of such a record as the consumer would have had against the assignee had the record contained the required notice.

5. **Scope; Application to "Account Debtor."** This section deals only with the rights and duties of "account debtors" and for the most part only with account debtors on accounts, chattel paper, and payment intangibles. Subsection (e) provides that the obligation of an insurer with respect to a health-care-insurance receivable is governed by other law. References in this section to an "account debtor" include account debtors on collateral that is proceeds. Neither this section nor any other provision of this Article, including Sections 9-408 and 9-409, provides analogous regulation of the rights and duties of other obligors on collateral, such as the maker of a negotiable instrument (governed by Article 3), the issuer of or nominated person under a letter of credit (governed by Article 5), or the issuer of a security (governed by Article 8). Article 9 leaves those rights and duties untouched; however, Section 9-409 deals with the special case of letters of credit. When chattel paper is composed in part of a negotiable instrument, the obligor on the instrument is not an "account debtor," and Article 3 governs the rights of the assignee of the chattel paper with respect to the issues that this section addresses. See, e.g., Section 3-601 (dealing with discharge of an obligation to pay a negotiable instrument).

ANNOTATION

Annotator's note. Since § 4-9-404 is similar to § 4-9-318 (1) as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

This section includes set-offs and counter

claims. Farmers Acceptance Corp. v. DeLozier, 179 Colo. 291, 496 P.2d 1016 (1972).

The right to receive money due or to become due under an existing contract may be assigned even though the contract itself may not be assignable. Farmers Acceptance Corp. v. DeLozier, 178 Colo. 291, 496 P.2d 1016 (1972).

Assignee is subject to defenses against assignor. An assignee of contract rights stands in the shoes of the assignor, has no greater rights against a debtor than does the assignor, and is subject to all equities and defenses which can be raised by a debtor against the assignor, with the exception of those claims and defenses which are both unrelated to the underlying contract and arise after a debtor is notified of the assignment. Farmers Acceptance Corp. v. DeLozier, 178 Colo. 291, 496 P.2d 1016 (1972).

Where an assignee obtains money which the assignor could only retain upon performance of a contract and the assignor fails to perform the contract, an assignee cannot retain mistaken, or even negligent, payments made to it by a debtor, unless there has been a subsequent change of position by assignee. Farmers Acceptance Corp. v. DeLozier, 178 Colo. 291, 496 P.2d 1016 (1972).

Where there is no evidence that an assignee relies to his detriment upon such a payment made by a debtor, the judgment of the trial court against him is proper in light of this section. Farmers Acceptance Corp. v. DeLozier, 178 Colo. 291, 496 P.2d 1016 (1972).

Agency relationship between dairyman debtor and agent responsible for marketing milk does not discharge debt to assignee. Mid-States Sales v. Mt. Empire Dairymen's, 741 P.2d 342 (Colo. App. 1987).

4-9-405. Modification of assigned contract. (a) A modification of or substitution for an assigned contract is effective against an assignee if made in good faith. The assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that the modification or substitution is a breach of contract by the assignor. This subsection (a) is subject to subsections (b) to (d) of this section.

(b) Subsection (a) of this section applies to the extent that:

(1) The right to payment or a part thereof under an assigned contract has not been fully earned by performance; or

(2) The right to payment or a part thereof has been fully earned by performance and the account debtor has not received notification of the assignment under section 4-9-406 (a).

(c) This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(d) This section does not apply to an assignment of a health-care-insurance receivable.

Source: L. 2001: Entire article R&RE, p. 1373, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-318 (2) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-318(2).

2. **Modification of Assigned Contract.** The ability of account debtors and assignors to modify assigned contracts can be important, especially in the case of government contracts and complex contractual arrangements (e.g., construction contracts) with respect to which modifications are customary. Subsections (a) and (b) provide that good-faith modifications of assigned contracts are binding against an assignee to the extent that (i) the right to payment has not been fully earned or (ii) the right to payment has been earned and notification of the assignment has not been given to the account debtor. Former Section 9-318(2) did not validate modifications of fully-performed contracts under any circumstances, whether or not notification of the assignment had been given to the account debtor. Subsection (a) protects the interests of assignees by (i) limiting the effectiveness of modifications to those made in good faith, (ii) affording the assignee with corresponding rights under the contract as modified, and (iii) recognizing that the modification may be a breach of the assignor's agreement with the assignee.

3. **Consumer Account Debtors.** Subsection (c) is new. It makes clear that the rules of this section are subject to other law establishing special rules for consumer account debtors.

4. **Account Debtors on Health-Care-Insurance Receivables.** Subsection (d) also is new. It provides that this section does not apply to an assignment of a heath-care-insurance receivable. The obligation of an insurer with respect to a health-care-insurance receivable is governed by other law.

ANNOTATION

Annotator's note. Section 4-9-405 is similar to § 4-9-318 (2) as it existed prior to the 2001 repeal and reenactment of this article. Relevant cases construing § 4-9-318 have been included in the annotations to § 4-9-404.

4-9-406. Discharge of account debtor - notification of assignment - identification and proof of assignment - restrictions on assignment of accounts, chattel paper, payment intangibles, and promissory notes ineffective. (a) Subject to subsections (b) to (i) of this section, an account debtor on an account, chattel paper, or a payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.

(b) Subject to subsection (h) of this section, notification is ineffective under subsection (a) of this section:

(1) If it does not reasonably identify the rights assigned;

(2) To the extent that an agreement between an account debtor and a seller of a payment intangible limits the account debtor's duty to pay a person other than the seller and the limitation is effective under law other than this article; or

(3) At the option of an account debtor, if the notification notifies the account debtor to make less than the full amount of any installment or other periodic payment to the assignee, even if:

(A) Only a portion of the account, chattel paper, or payment intangible has been assigned to that assignee;

(B) A portion has been assigned to another assignee; or

(C) The account debtor knows that the assignment to that assignee is limited.

(c) Subject to subsection (h) of this section, if requested by the account debtor, an assignee shall seasonably furnish reasonable proof that the assignment has been made. Unless the assignee complies, the account debtor may discharge its obligation by paying the assignor, even if the account debtor has received a notification under subsection (a) of this section.

(d) Except as otherwise provided in subsections (e) and (k) of this section and sections 4-2.5-303, 4-9-407, 8-80-103, 8-42-124, 13-64-210, and 24-4.1-114, C.R.S., and subject to subsection (h) of this section, a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:

(1) Prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note; or

(2) Provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account, chattel paper, payment intangible, or promissory note.

(e) Subsection (d) of this section does not apply to the sale of a payment intangible or promissory note.

Editor's note: This version of subsection (e) is effective until July 1, 2013.

(e) Subsection (d) of this section does not apply to the sale of a payment intangible or promissory note, other than a sale pursuant to a disposition under section 4-9-610 or an acceptance of collateral under section 4-9-620.

Editor's note: This version of subsection (e) is effective July 1, 2013.

(f) Except as otherwise provided in sections 4-2.5-303, 4-9-407, 8-80-103, 8-42-124, 13-64-210, and 24-4.1-114, C.R.S., and subject to subsections (h) and (i) of this section, a rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a

government, governmental body or official, or account debtor to the assignment or transfer of, or creation of a security interest in, an account or chattel paper is ineffective to the extent that the rule of law, statute, or regulation:

(1) Prohibits, restricts, or requires the consent of the government, governmental body or official, or account debtor to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in the account or chattel paper; or

(2) Provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account or chattel paper.

(g) Subject to subsection (h) of this section, an account debtor may not waive or vary its option under paragraph (3) of subsection (b) of this section.

(h) This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(i) This section does not apply to an assignment of a health-care-insurance receivable.

(j) Reserved.

(k) Subsection (d) of this section does not apply to the assignment, transfer, or creation of a security interest in:

(1) A claim or right to receive compensation for injuries or sickness as described in 26 U.S.C. sec. 104 (a) (1) or (2), as amended; or

(2) A claim or right to receive benefits under a special needs trust as described in 42 U.S.C. sec. 1396p (d) (4), as amended.

Source: L. 2001: Entire article R&RE, p. 1373, § 1, effective July 1. **L. 2012:** (e) amended, (HB 12-1262), ch. 170, p. 599, § 8, effective July 1, 2013.

Editor's note: (1) This section is similar to former § 4-9-318 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado substituted the word "payment" for the word "general" in subsection (b)(3)(A), added the phrase "assignment or transfer or the" in subsection (d)(2), and added subsection (k).

OFFICIAL COMMENT

1. **Source.** Former Section 9-318(3), (4).

2. **Account Debtor's Right to Pay Assignor Until Notification.** Subsection (a) provides the general rule concerning an account debtor's right to pay the assignor until the account debtor receives appropriate notification. The revision makes clear that once the account debtor receives the notification, the account debtor cannot discharge its obligation by paying the assignor. It also makes explicit that payment to the assignor before notification, or payment to the assignee after notification, discharges the obligation. No change in meaning from former Section 9-318 is intended. Nothing in this section conditions the effectiveness of a notification on the identity of the person who gives it. An account debtor that doubts whether the right to payment has been assigned may avail itself of the procedures in subsection (c). See Comment 4.

An effective notification under subsection (a) must be authenticated. This requirement normally could be satisfied by sending notification on the notifying person's letterhead or on a form on which the notifying person's name appears. In each case the printed name would be a symbol adopted by the notifying person for the purpose of identifying the person and adopting the notification. See Section 9-102 (defining "authenticate").

Subsection (a) applies only to account debtors on accounts, chattel paper, and payment intangibles. (Section 9-102 defines the term "account debtor" more broadly, to include those obligated on all general intangibles.) Although subsection (a) is more precise than its predecessor, it probably does not change the rule that applied under former Article 9. Former Section 9-318(3) referred to the account debtor's obligation to "pay," indicating that the subsection was limited to account debtors on accounts, chattel paper, and other payment obligations.

3. **Limitations on Effectiveness of Notification.** Subsection (b) contains some special rules concerning the effectiveness of a notification under subsection (a).

Subsection (b)(1) tracks former Section 9-318(3) by making ineffective a notification that does not reasonably identify the rights assigned. A reasonable identification need not identify the right to payment with specificity, but what is reasonable also is not left to the arbitrary

decision of the account debtor. If an account debtor has doubt as to the adequacy of a notification, it may not be safe in disregarding the notification unless it notifies the assignee with reasonable promptness as to the respects in which the account debtor considers the notification defective.

Subsection (b)(2), which is new, applies only to sales of payment intangibles. It makes a notification ineffective to the extent that other law gives effect to an agreement between an account debtor and a seller of a payment intangible that limits the account debtor's duty to pay a person other than the seller. Payment intangibles are substantially less fungible than accounts and chattel paper. In some (e.g., commercial bank loans), account debtors customarily and legitimately expect that they will not be required to pay any person other than the financial institution that has advanced funds.

It has become common in financing transactions to assign interests in a single obligation to more than one assignee. Requiring an account debtor that owes a single obligation to make multiple payments to multiple assignees would be unnecessarily burdensome. Thus, under subsection (b)(3), an account debtor that is notified to pay an assignee less than the full amount of any installment or other periodic payment has the option to treat the notification as ineffective, ignore the notice, and discharge the assigned obligation by paying the assignor. Some account debtors may not realize that the law affords them the right to ignore certain notices of assignment with impunity. By making the notification ineffective at the account debtor's option, subsection (b)(3) permits an account debtor to pay the assignee in accordance with the notice and thereby to satisfy its obligation *pro tanto*. Under subsection (g), the rights and duties created by subsection (b)(3) cannot be waived or varied.

4. **Proof of Assignment.** Subsection (c) links payment with discharge, as in subsection (a). It follows former Section 9-318(3) in referring to the right of the account debtor to pay the assignor if the requested proof of assignment is not seasonably forthcoming. Even if the proof is not forthcoming, the notification of assignment would remain effective, so that, in the absence of reasonable proof of the assignment, the account debtor could discharge the obligation by paying either the assignee or the assignor. Of course, if the assignee did not in fact receive an assignment, the account debtor cannot discharge its obligation by paying a putative assignee who is a stranger. The observations in Comment 3 concerning the reasonableness of an identification of a right to payment also apply here. An account debtor that questions the adequacy of proof submitted by an assignor would be well advised to promptly inform the assignor of the defects.

An account debtor may face another problem if its obligation becomes due while the account debtor is awaiting reasonable proof of the assignment that it has requested from the assignee. This section does not excuse the account debtor from timely compliance with its obligations. Consequently, an account debtor that has received a notification of assignment and who has requested reasonable proof of the assignment may discharge its obligation by paying the assignor at the time (or even earlier if reasonably necessary to avoid risk of default) when a payment is due, even if the account debtor has not yet received a response to its request for proof. On the other hand, after requesting reasonable proof of the assignment, an account debtor may not discharge its obligation by paying the assignor substantially in advance of the time that the payment is due unless the assignee has failed to provide the proof seasonably.

5. **Contractual Restrictions on Assignment.** Former Section 9-318(4) rendered ineffective an agreement between an account debtor and an assignor which prohibited assignment of an account (whether outright or to secure an obligation) or prohibited a security assignment of a general intangible for the payment of money due or to become due. Subsection (d) essentially follows former Section 9-318(4), but expands the rule of free assignability to chattel paper (subject to Sections 2A-303 and 9-407) and promissory notes and explicitly overrides both restrictions and prohibitions of assignment. The policies underlying the ineffectiveness of contractual restrictions under this section build on common-law developments that essentially have eliminated legal restrictions on assignments of rights to payment as security and other assignments of rights to payment such as accounts and chattel paper. Any that might linger for accounts and chattel paper are addressed by new subsection (f). See Comment 6.

Former Section 9-318(4) did not apply to a sale of a payment intangible (as described in the former provision, "a general intangible for money due or to become due") but did apply to an assignment of a payment intangible for security. Subsection (e) continues this approach and also makes subsection (d) inapplicable to sales of promissory notes. Section 9-408 addresses anti- assignment clauses with respect to sales of payment intangibles and promissory notes.

Like former Section 9-318(4), subsection (d) provides that anti-assignment clauses are "ineffective." The quoted term means that the clause is of no effect whatsoever; the clause does not prevent the assignment from taking effect between the parties and the prohibited assignment does not constitute a default under the agreement between the account debtor and assignor. However, subsection (d) does not override terms that do not directly prohibit, restrict, or require consent to an assignment but which might,

nonetheless, present a practical impairment of the assignment. Properly read, however, subsection (d) reaches only covenants that prohibit, restrict, or require consents to assignments; it does not override all terms that might "impair" an assignment in fact.

Example: Buyer enters into an agreement with Seller to buy equipment that Seller is to manufacture according to Buyer's specifications. Buyer agrees to make a series of prepayments during the construction process. In return, Seller agrees to set aside the prepaid funds in a special account and to use the funds solely for the manufacture of the designated equipment. Seller also agrees that it will not assign any of its rights under the sale agreement with Buyer. Nevertheless, Seller grants to Secured Party a security interest in its accounts. Seller's anti-assignment agreement is ineffective under subsection (d); its agreement concerning the use of prepaid funds, which is not a restriction or prohibition on assignment, is not. However, if Secured Party notifies Buyer to make all future payments directly to Secured Party, Buyer will be obliged to do so under subsection (a) if it wishes the payments to discharge its obligation. Unless Secured Party releases the funds to Seller so that Seller can comply with its use-of-funds covenant, Seller will be in breach of that covenant.

In the example, there appears to be a plausible business purpose for the use-of-funds covenant. However, a court may conclude that a covenant with no business purpose other than imposing an impediment to an assignment actually is a direct restriction that is rendered ineffective by subsection (d).

6. **Legal Restrictions on Assignment.** Former Section 9-318(4), like subsection (d) of this section, addressed only contractual restrictions on assignment. The former section was grounded on the reality that legal, as opposed to contractual, restrictions on assignments of rights to payment had largely disappeared. New subsection (f) codifies this principle of free assignability for accounts and chattel paper. For the most part the discussion of contractual restrictions in Comment 5 applies as well to legal restrictions rendered ineffective under subsection (f).

7. **Multiple Assignments.** This section, like former Section 9-318, is not a complete codification of the law of assignments of rights to payment. In particular, it is silent concerning many of the ramifications for an account debtor in cases of multiple assignments of the same right. For example, an assignor might assign the same receivable to multiple assignees (which assignments could be either inadvertent or wrongful). Or, the assignor could assign the receivable to assignee-1, which then might reassign it to assignee-2, and so forth. The rights and duties of an account debtor in the face of multiple assignments and in other circumstances not resolved in the statutory text are left to the common-law rules. See, e.g., Restatement (2d), Contracts §§ 338(3), 339. The failure of former Article 9 to codify these rules does not appear to have caused problems.

8. **Consumer Account Debtors.** Subsection (h) is new. It makes clear that the rules of this section are subject to other law establishing special rules for consumer account debtors.

9. **Account Debtors on Health-Care-Insurance Receivables.** Subsection (i) also is new. The obligation of an insurer with respect to a health-care-insurance receivable is governed by other law. Section 9-408 addresses contractual and legal restrictions on the assignment of a health-care-insurance receivable.

ANNOTATION

Annotator's note. Section 4-9-406 is similar to § 4-9-318 as it existed prior to the 2001 repeal and reenactment of this article. Relevant cases construing § 4-9-318 have been included in the annotations to § 4-9-404.

4-9-407. Restrictions on creation or enforcement of security interest in leasehold interest or in lessor's residual interest. (a) Except as otherwise provided in subsection (b) of this section, a term in a lease agreement is ineffective to the extent that it:

(1) Prohibits, restricts, or requires the consent of a party to the lease to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, an interest of a party under the lease contract or in the lessor's residual interest in the goods; or

(2) Provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the lease.

(b) Except as otherwise provided in section 4-2.5-303 (7), a term described in paragraph (2) of subsection (a) of this section is effective to the extent that there is:

(1) A transfer by the lessee of the lessee's right of possession or use of the goods in violation of the term; or

(2) A delegation of a material performance of either party to the lease contract in violation of the term.

(c) The creation, attachment, perfection, or enforcement of a security interest in the lessor's interest under the lease contract or the lessor's residual interest in the goods is not a transfer that materially impairs the lessee's prospect of obtaining return performance or materially changes the duty of or materially increases the burden or risk imposed on the lessee within the purview of section 4-2.5-303 (4) unless, and then only to the extent that, enforcement actually results in a delegation of material performance of the lessor.

Source: L. 2001: Entire article R&RE, p. 1375, § 1, effective July 1.

Editor's note: This section is similar to former § 4-2.5-303 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Section 2A-303.

2. **Restrictions on Assignment Generally Ineffective.** Under subsection (a), as under former Section 2A-303(3), a term in a lease agreement which prohibits or restricts the creation of a security interest generally is ineffective. This reflects the general policy of Section 9-406(d) and former Section 9-318(4). This section has been conformed in several respects to analogous provisions in Sections 9-406, 9-408, and 9-409, including the substitution of "ineffective" for "not enforceable" and the substitution of "assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest" for "creation or enforcement of a security interest."

3. **Exceptions for Certain Transfers and Delegations.** Subsection (b) provides exceptions to the general ineffectiveness of restrictions under subsection (a). A term that otherwise is ineffective under subsection (a)(2) is effective to the extent that a lessee transfers its right to possession and use of goods or if either party delegates material performance of the lease contract in violation of the term. However, under subsection (c), as under former Section 2A-303(3), a lessor's creation of a security interest in its interest in a lease contract or its residual interest in the leased goods is not a material impairment under Section 2A-303(4) (former Section 2A-303(5)), absent an actual delegation of the lessor's material performance. The terms of the lease contract determine whether the lessor, in fact, has any remaining obligations to perform. If it does, it is then necessary to determine whether there has been an actual delegation of "material performance." See Section 2A-303, Comments 3 and 4.

4-9-408. Restrictions on assignment of promissory notes, health-care-insurance receivables, and certain general intangibles ineffective. (a) Except as otherwise provided in subsection (b) of this section, a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or a general intangible, including a contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or creation, attachment, or perfection of a security interest in, the promissory note, health-care-insurance receivable, or general intangible, is ineffective to the extent that the term:

(1) Would impair the creation, attachment, or perfection of a security interest; or

(2) Provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

(b) Subsection (a) of this section applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note.

Editor's note: This version of subsection (b) is effective until July 1, 2013.

(b) Subsection (a) of this section applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note, other than a sale pursuant to a disposition under section 4-9-610 or an acceptance of collateral under section 4-9-620.

Editor's note: This version of subsection (b) is effective July 1, 2013.

(c) Except as provided in sections 8-80-103 and 8-42-124, C.R.S., a rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, person obligated on a promissory note, or account debtor to the assignment or transfer of, or creation of a security interest in, a promissory note, health-care-insurance receivable, or general intangible, including a contract, permit, license, or franchise between an account debtor and a debtor, is ineffective to the extent that the rule of law, statute, or regulation:

(1) Would impair the creation, attachment, or perfection of a security interest; or

(2) Provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

(d) To the extent that a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or general intangible or a rule of law, statute, or regulation described in subsection (c) of this section would be effective under law other than this article but is ineffective under subsection (a) or (c) of this section, the creation, attachment, or perfection of a security interest in the promissory note, health-care-insurance receivable, or general intangible:

(1) Is not enforceable against the person obligated on the promissory note or the account debtor;

(2) Does not impose a duty or obligation on the person obligated on the promissory note or the account debtor;

(3) Does not require the person obligated on the promissory note or the account debtor to recognize the security interest, pay or render performance to the secured party, or accept payment or performance from the secured party;

(4) Does not entitle the secured party to use or assign the debtor's rights under the promissory note, health-care-insurance receivable, or general intangible, including any related information or materials furnished to the debtor in the transaction giving rise to the promissory note, health-care-insurance receivable, or general intangible;

(5) Does not entitle the secured party to use, assign, possess, or have access to any trade secrets or confidential information of the person obligated on the promissory note or the account debtor; and

(6) Does not entitle the secured party to enforce the security interest in the promissory note, health-care-insurance receivable, or general intangible.

(e) Reserved.

(f) Subsections (a) and (c) of this section do not apply to the assignment, transfer, or creation of a security interest in:

(1) A claim or right to receive compensation for injuries or sickness as described in 26 U.S.C. sec. 104 (a) (1) or (2), as amended; or

(2) A claim or right to receive benefits under a special needs trust as described in 42 U.S.C. sec. 1396p (d) (4), as amended.

Source: L. 2001: Entire article R&RE, p. 1376, § 1, effective July 1. **L. 2012:** (b) amended, (HB 12-1262), ch. 170, p. 599, § 9, effective July 1, 2013.

Editor's note - Colorado legislative change: Colorado added the phrase "Except as provided in sections 8-80-103 and 8-42-124, C.R.S.," to subsection (c) and added subsection (f).

OFFICIAL COMMENT

1. **Source.** New.

2. **Free Assignability.** This section makes ineffective any attempt to restrict the assignment of a general intangible, health-care-insurance receivable, or promissory note, whether the restriction appears in the terms of a promissory note or the agreement between an account debtor and a debtor (subsection (a)) or in a rule of law, including a statute or governmental rule or regulation (subsection (c)). This result allows the creation, attachment, and perfection of a security interest in a general intangible, such as an agreement for the nonexclusive license of software, as well as sales of certain receivables,

such as a health-care-insurance receivable (which is an "account"), payment intangible, or promissory note, without giving rise to a default or breach by the assignor or from triggering a remedy of the account debtor or person obligated on a promissory note. This enhances the ability of certain debtors to obtain credit. On the other hand, subsection (d) protects the other party the "account debtor" on a general intangible or the person obligated on a promissory note from adverse effects arising from the security interest. It leaves the account debtor's or obligated person's rights and obligations unaffected in all material respects if a restriction rendered ineffective by subsection (a) or (c) would be effective under law other than Article 9.

Example 1: A term of an agreement for the nonexclusive license of computer software prohibits the licensee from assigning any of its rights as licensee with respect to the software. The agreement also provides that an attempt to assign rights in violation of the restriction is a default entitling the licensor to terminate the license agreement. The licensee, as debtor, grants to a secured party a security interest in its rights under the license and in the computers in which it is installed. Under this section, the term prohibiting assignment and providing for a default upon an attempted assignment is ineffective to prevent the creation, attachment, or perfection of the security interest or entitle the licensor to terminate the license agreement. However, under subsection (d), the secured party (absent the licensor's agreement) is not entitled to enforce the license or to use, assign, or otherwise enjoy the benefits of the licensed software, and the licensor need not recognize (or pay any attention to) the secured party. Even if the secured party takes possession of the computers on the debtor's default, the debtor would remain free to remove the software from the computer, load it on another computer, and continue to use it, if the license so permits. If the debtor does not remove the software, other law may require the secured party to remove it before disposing of the computer. Disposition of the software with the computer could violate an effective prohibition on enforcement of the security interest. See subsection (d).

3. **Nature of Debtor's Interest.** Neither this section nor any other provision of this Article determines whether a debtor has a property interest. The definition of the term "security interest" provides that it is an "interest in personal property." See Section 1-201(37). Ordinarily, a debtor can create a security interest in collateral only if it has "rights in the collateral." See Section 9-203(b). Other law determines whether a debtor has a property interest ("rights in the collateral") and the nature of that interest. For example, the nonexclusive license addressed in Example 1 may not create any property interest whatsoever in the intellectual property (e.g., copyright) that underlies the license and that effectively enables the licensor to grant the license. The debtor's property interest may be confined solely to its interest in the promises made by the licensor in the license agreement (e.g., a promise not to sue the debtor for its use of the software).

Note: "1-201(37)." in the third sentence will be replaced with "1-201(b)(35)." effective July 1, 2013.

4. **Scope: Sales of Payment Intangibles and Other General Intangibles; Assignments Unaffected by this Section.** Subsections (a) and (c) render ineffective restrictions on assignments only "to the extent" that the assignments restrict the "creation, attachment, or perfection of a security interest," including sales of payment intangibles and promissory notes. This section does not render ineffective a restriction on an assignment that does not create a security interest. For example, if the debtor in Comment 2, Example 1 purported to assign the license to another entity that would use the computer software itself, other law would govern the effectiveness of the anti- assignment provisions.

Subsection (a) applies to a security interest in payment intangibles only if the security interest arises out of sale of the payment intangibles. Contractual restrictions directed to security interests in payment intangibles which secure an obligation are subject to Section 9-406(d). Subsection (a) also deals with sales of promissory notes which also create security interests. See Section 9-109(a). Subsection (c) deals with all security interests in payment intangibles or promissory notes, whether or not arising out of a sale.

Subsection (a) does not render ineffective any term, and subsection (c) does not render ineffective any law, statute or regulation, that restricts outright sales of general intangibles other than payment intangibles. They deal only with restrictions on security interests. The only sales of general intangibles that create security interests are sales of payment intangibles.

5. **Terminology: "Account Debtor"; "Person Obligated on a Promissory Note."** This section uses the term "account debtor" as it is defined in Section 9-102. The term refers to the party, other than the debtor, to a general intangible, including a permit, license, franchise, or the like, and the person obligated on a health-care-insurance receivable, which is a type of account. The definition of "account debtor" does not limit the term to persons who are obligated to *pay* under a general intangible. Rather, the term includes all persons who are obligated on a general intangible, including those who are obligated to render performance in exchange for payment. In some cases, e.g., the creation of a security interest in a franchisee's rights under a franchise agreement, the

principal payment obligation may be owed *by* the debtor (franchisee) *to* the account debtor (franchisor). This section also refers to a "person obligated on a promissory note," inasmuch as those persons do not fall within the definition of "account debtor."

Example 2: A licensor and licensee enter into an agreement for the nonexclusive license of computer software. The licensee's interest in the license agreement is a general intangible. If the licensee grants to a secured party a security interest in its rights under the license agreement, the licensee is the debtor and the licensor is the account debtor. On the other hand, if the licensor grants to a secured party a security interest in its right to payment (an account) under the license agreement, the licensor is the debtor and the licensee is the account debtor. (This section applies to the security interest in the general intangible but not to the security interest in the account, which is not a health-care-insurance receivable.)

6. **Effects on Account Debtors and Persons Obligated on Promissory Notes.** Subsections (a) and (c) affect two classes of persons. These subsections affect account debtors on general intangibles and health-care-insurance receivables and persons obligated on promissory notes. Subsection (c) also affects governmental entities that enact or determine rules of law. *However, subsection (d) ensures that these affected persons are not affected adversely.* That provision removes any burdens or adverse effects on these persons for which any rational basis could exist to restrict the effectiveness of an assignment or to exercise any remedies. For this reason, the effects of subsections (a) and (c) are immaterial insofar as those persons are concerned.

Subsection (a) does not override terms that do not directly prohibit, restrict, or require consent to an assignment but which might, nonetheless, present a practical impairment of the assignment. Properly read, however, this section, like Section 9-406(d), reaches only covenants that prohibit, restrict, or require consents to assignments; it does not override all terms that might "impair" an assignment in fact.

Example 3: A licensor and licensee enter into an agreement for the nonexclusive license of valuable business software. The license agreement includes terms (i) prohibiting the licensee from assigning its rights under the license, (ii) prohibiting the licensee from disclosing to anyone certain information relating to the software and the licensor, and (iii) deeming prohibited assignments and prohibited disclosures to be defaults. The licensee wishes to obtain financing and, in exchange, is willing to grant a security interest in its rights under the license agreement. The secured party, reasonably, refuses to extend credit unless the licensee discloses the information that it is prohibited from disclosing under the license agreement. The secured party cannot determine the value of the proposed collateral in the absence of this information. Under this section, the terms of the license prohibiting the assignment (grant of the security interest) and making the assignment a default are ineffective. However, the nondisclosure covenant is not a term that prohibits the assignment or creation of a security interest in the license. Consequently, the nondisclosure term is enforceable even though the *practical* effect is to restrict the licensee's ability to use its rights under the license agreement as collateral.

The nondisclosure term also would be effective in the factual setting of Comment 2, Example 1. If the secured party's possession of the computers loaded with software would put it in a position to discover confidential information that the debtor was prohibited from disclosing, the licensor should be entitled to enforce its rights against the secured party. Moreover, the licensor could have required the debtor to obtain the secured party's agreement that (i) it would immediately return all copies of software loaded on the computers and that (ii) it would not examine or otherwise acquire any information contained in the software. This section does not prevent an account debtor from protecting by agreement its independent interests that are unrelated to the "creation, attachment, or perfection" of a security interest. In Example 1, moreover, the secured party is not in possession of copies of software by virtue of its security interest or in connection with enforcing its security interest *in the debtor's license of the software.* Its possession is incidental to its possession of the computers, in which it has a security interest. Enforcing against the secured party a restriction relating to the software in no way interferes with its security interest in the computers.

7. **Effect in Assignor's Bankruptcy.** This section could have a substantial effect if the assignor enters bankruptcy. Roughly speaking, Bankruptcy Code Section 552 invalidates security interests in property acquired after a bankruptcy petition is filed, except to the extent that the postpetition property constitutes proceeds of prepetition collateral.

Example 4: A debtor is the owner of a cable television franchise that, under applicable law, cannot be assigned without the consent of the municipal franchisor. A lender wishes to extend credit to the debtor, provided that the credit is secured by the debtor's "going business" value. To secure the loan, the debtor grants a security interest in all its existing and after-acquired property. The franchise represents the principal value of the business. The municipality refuses to consent to any assignment for collateral purposes. If other law were given effect, the security interest in the franchise would not attach; and if the debtor were to enter bankruptcy and

sell the business, the secured party would receive but a fraction of the business's value. Under this section, however, the security interest would attach to the franchise. As a result, the security interest would attach to the proceeds of any sale of the franchise while a bankruptcy is pending. However, this section would protect the interests of the municipality by preventing the secured party from enforcing its security interest to the detriment of the municipality.

8. **Effect Outside of Bankruptcy.** The principal effects of this section will take place outside of bankruptcy. Compared to the relatively few debtors that enter bankruptcy, there are many more that do not. By making available previously unavailable property as collateral, this section should enable debtors to obtain additional credit. For purposes of determining whether to extend credit, under some circumstances a secured party may ascribe value to the collateral to which its security interest has attached, even if this section precludes the secured party from enforcing the security interest without the agreement of the account debtor or person obligated on the promissory note. This may be the case where the secured party sees a likelihood of obtaining that agreement in the future. This may also be the case where the secured party anticipates that the collateral will give rise to a type of proceeds as to which this section would not apply.

Example 5: Under the facts of Example 4, the debtor does not enter bankruptcy. Perhaps in exchange for a fee, the municipality agrees that the debtor may transfer the franchise to a buyer. As consideration for the transfer, the debtor receives from the buyer its check for part of the purchase price and its promissory note for the balance. The security interest attaches to the check and promissory note as proceeds. See Section 9-315(a)(2). This section does not apply to the security interest in the check, which is not a promissory note, health-care-insurance receivable, or general intangible. Nor does it apply to the security interest in the promissory note, inasmuch as it was not sold to the secured party.

9. **Contrary Federal Law.** This section does not override federal law to the contrary. However, it does reflect an important policy judgment that should provide a template for future federal law reforms.

4-9-409. Restrictions on assignment of letter-of-credit rights ineffective. (a) A term in a letter of credit or a rule of law, statute, regulation, custom, or practice applicable to the letter of credit which prohibits, restricts, or requires the consent of an applicant, issuer, or nominated person to a beneficiary's assignment of or creation of a security interest in a letter-of-credit right is ineffective to the extent that the term or rule of law, statute, regulation, custom, or practice:

(1) Would impair the creation, attachment, or perfection of a security interest in the letter-of-credit right; or

(2) Provides that the assignment or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the letter-of-credit right.

(b) To the extent that a term in a letter of credit is ineffective under subsection (a) of this section but would be effective under law other than this article or a custom or practice applicable to the letter of credit, to the transfer of a right to draw or otherwise demand performance under the letter of credit, or to the assignment of a right to proceeds of the letter of credit, the creation, attachment, or perfection of a security interest in the letter-of-credit right:

(1) Is not enforceable against the applicant, issuer, nominated person, or transferee beneficiary;

(2) Imposes no duties or obligations on the applicant, issuer, nominated person, or transferee beneficiary; and

(3) Does not require the applicant, issuer, nominated person, or transferee beneficiary to recognize the security interest, pay or render performance to the secured party, or accept payment or other performance from the secured party.

Source: L. 2001: Entire article R&RE, p. 1377, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Purpose and Relevance.** This section, patterned on Section 9-408, limits the effectiveness of attempts to restrict the creation, attachment, or perfection of a security interest in letter-of-credit rights, whether the restriction appears in the letter of credit or a rule of law, custom, or practice applicable to the letter of

credit. It protects the creation, attachment, and perfection of a security interest while preventing these events from giving rise to a default or breach by the assignor or from triggering a remedy or defense of the issuer or other person obligated on a letter of credit. Letter-of-credit rights are a type of supporting obligation. See Section 9-102. Under Sections 9-203 and 9-308, a security interest in a supporting obligation attaches and is perfected automatically if the security interest in the supported obligation attaches and is perfected. See Section 9-107, Comment 5. The automatic attachment and perfection under Article 9 would be anomalous or misleading if, under other law (e.g., Article 5), a restriction on transfer or assignment were effective to block attachment and perfection.

3. **Relationship to Letter-of-Credit Law.** Although restrictions on an assignment of a letter of credit are ineffective to prevent creation, attachment, and perfection of a security interest, subsection (b) protects the issuer and other parties from any adverse effects of the security interest by preserving letter-of-credit law and practice that limits the right of a beneficiary to transfer its right to draw or otherwise demand performance (Section 5-112) and limits the obligation of an issuer or nominated person to recognize a beneficiary's assignment of letter-of-credit proceeds (Section 5-114). Thus, this section's treatment of letter-of-credit rights differs from this Article's treatment of instruments and investment property. Moreover, under Section 9-109(c)(4), this Article does not apply to the extent that the rights of a transferee beneficiary or nominated person are independent and superior under Section 5-114, thereby preserving the "independence principle" of letter-of-credit law.

PART 5

FILING

4-9-501. Filing office. (a) Except as otherwise provided in subsection (b) of this section, if the local law of this state governs perfection of a security interest or agricultural lien, the office in which to file a financing statement to perfect the security interest or agricultural lien is:

(1) The office designated for the filing or recording of a record of a mortgage on the related real property, if:

(A) The collateral is as-extracted collateral or timber to be cut; or

(B) The financing statement is filed as a fixture filing and the collateral is goods that are or are to become fixtures; or

(2) The office of the secretary of state, in all other cases, including a case in which the collateral is goods that are or are to become fixtures and the financing statement is not filed as a fixture filing.

(b) The office in which to file a financing statement to perfect a security interest in collateral, including fixtures, of a transmitting utility is the office of the secretary of state. The financing statement also constitutes a fixture filing as to the collateral indicated in the financing statement which is or is to become fixtures.

(c) The office in which to file an effective financing statement pursuant to article 9.5 of this title is the office of the secretary of state.

Source: L. 2001: Entire article R&RE, p. 1378, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado added subsection (c).

OFFICIAL COMMENT

1. **Source.** Derived from former Section 9-401.

2. **Where to File.** Subsection (a) indicates where in a given State a financing statement is to be filed. Former Article 9 afforded each State three alternative approaches, depending on the extent to which the State desires central filing (usually with the Secretary of State), local filing (usually with a county office), or both. As Comment 1 to former Section 9-401 observed, "The principal advantage of state-wide filing is ease of access to the credit information which the files exist to provide. Consider for example the national distributor who wishes to have current information about the credit standing of the thousands of persons he sells to on credit. The more completely the files are centralized on a state-wide basis, the easier and cheaper it becomes to procure credit information; the more the files are scattered in local filing units, the

more burdensome and costly." Local filing increases the net costs of secured transactions also by increasing uncertainty and the number of required filings. Any benefit that local filing may have had in the 1950's is now insubstantial. Accordingly, this Article dictates central filing for most situations, while retaining local filing for real-estate-related collateral and special filing provisions for transmitting utilities.

3. **Minerals and Timber.** Under subsection (a)(1), a filing in the office where a record of a mortgage on the related real property would be filed will perfect a security interest in as-extracted collateral. Inasmuch as the security interest does not attach until extraction, the filing continues to be effective after extraction. A different result occurs with respect to timber to be cut, however. Unlike as-extracted collateral, standing timber may be goods before it is cut. See Section 9-102 (defining "goods"). Once cut, however, it is no longer timber *to be* cut, and the filing in the real-property-mortgage office ceases to be effective. The timber then becomes ordinary goods, and filing in the office specified in subsection (a)(2) is necessary for perfection. Note also that after the timber is cut the law of the debtor's location, not the location of the timber, governs perfection under Section 9-301.

4. **Fixtures.** There are two ways in which a secured party may file a financing statement to perfect a security interest in goods that are or are to become fixtures. It may file in the Article 9 records, as with most other goods. See subsection (a)(2). Or it may file the financing statement as a "fixture filing," defined in Section 9-102, in the office in which a record of a mortgage on the related real property would be filed. See subsection(a)(1)(B).

5. **Transmitting Utilities.** The usual filing rules do not apply well for a transmitting utility (defined in Section 9-102). Many pre-UCC statutes provided special filing rules for railroads and in some cases for other public utilities, to avoid the requirements for filing with legal descriptions in every county in which such debtors had property. Former Section 9-401(5) recreated and broadened these provisions, and subsection (b) follows this approach. The nature of the debtor will inform persons searching the record as to where to make a search.

[A given State's subsection (b) applies only if the local law of that State governs perfection. As to most collateral, perfection by filing is governed by the law of the jurisdiction in which the debtor is located. See Section 9-301(1). However, the law of the jurisdiction in which goods that are or become fixtures are located governs perfection by filing a fixture filing. See Section 9-301(3)(A). As a consequence, filing in the filing office of more than one State may be necessary to perfect a security interest in fixtures collateral of a transmitting utility by filing a fixture filing. See Section 9-301, Comment 5.b.]
Note: The bracketed language takes effect July 1, 2013.

4-9-502. Contents of financing statement - record of mortgage as financing statement - time of filing financing statement. (a) Subject to subsection (b) of this section, a financing statement is sufficient only if it:

(1) Provides the name of the debtor;

(2) Provides the name of the secured party or a representative of the secured party; and

(3) Indicates the collateral covered by the financing statement.

(b) Except as otherwise provided in section 4-9-501 (b), to be sufficient, a financing statement that covers as-extracted collateral or timber to be cut, or which is filed as a fixture filing and covers goods that are or are to become fixtures, must satisfy subsection (a) of this section and also:

(1) Indicate that it covers this type of collateral;

(2) Indicate that it is to be filed for record in the real property records;

(3) Provide a description of the real property to which the collateral is related sufficient to give constructive notice of a mortgage under the law of this state if the description were contained in a record of the mortgage of the real property; and

(4) If the debtor does not have an interest of record in the real property, provide the name of a record owner.

(c) A record of a mortgage is effective, from the date of recording, as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut only if:

(1) The record indicates the goods or accounts that it covers;

(2) The goods are or are to become fixtures related to the real property described in the record or the collateral is related to the real property described in the record and is as-extracted collateral or timber to be cut;

(3) The record satisfies the requirements for a financing statement in this section other than an indication that it is to be filed in the real property records; and

(4) The record is duly recorded.

(d) A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.

Source: L. 2001: Entire article R&RE, p. 1379, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-402 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-402(1), (5), (6).

2. **"Notice Filing."** This section adopts the system of "notice filing." What is required to be filed is not, as under pre-UCC chattel mortgage and conditional sales acts, the security agreement itself, but only a simple record providing a limited amount of information (financing statement). The financing statement may be filed before the security interest attaches or thereafter. See subsection (d). See also Section 9-308(a) (contemplating situations in which a financing statement is filed before a security interest attaches).

The notice itself indicates merely that a person may have a security interest in the collateral indicated. Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs. Section 9-210 provides a statutory procedure under which the secured party, at the debtor's request, may be required to make disclosure. However, in many cases, information may be forthcoming without the need to resort to the formalities of that section.

Notice filing has proved to be of great use in financing transactions involving inventory, accounts, and chattel paper, because it obviates the necessity of refiling on each of a series of transactions in a continuing arrangement under which the collateral changes from day to day. However, even in the case of filings that do not necessarily involve a series of transactions (e.g., a loan secured by a single item of equipment), a financing statement is effective to encompass transactions under a security agreement not in existence and not contemplated at the time the notice was filed, if the indication of collateral in the financing statement is sufficient to cover the collateral concerned. Similarly, a financing statement is effective to cover after-acquired property of the type indicated and to perfect with respect to future advances under security agreements, regardless of whether after-acquired property or future advances are mentioned in the financing statement and even if not in the contemplation of the parties at the time the financing statement was authorized to be filed.

3. **Debtor's Signature; Required Authorization.** Subsection (a) sets forth the simple formal requirements for an effective financing statement. These requirements are: (1) the debtor's name; (2) the name of a secured party or representative of the secured party; and (3) an indication of the collateral.

Whereas former Section 9-402(1) required the debtor's signature to appear on a financing statement, this Article contains no signature requirement. The elimination of the signature requirement facilitates paperless filing. (However, as PEB Commentary No. 15 indicates, a paperless financing statement was sufficient under former Article 9.) Elimination of the signature requirement also makes the exceptions provided by former Section 9-402(2) unnecessary.

The fact that this Article does not require that an authenticating symbol be contained in the public record does not mean that all filings are authorized. Rather, Section 9-509(a) entitles a person to file an initial financing statement, an amendment that adds collateral, or an amendment that adds a debtor only if the debtor authorizes the filing, and Section 9-509(d) entitles a person other than the debtor to file a termination statement only if the secured party of record authorizes the filing. Of course, a filing has legal effect only to the extent it is authorized. See Section 9-510.

Law other than this Article, including the law with respect to ratification of past acts, generally determines whether a person has the requisite authority to file a record under this Article. See Sections 1-103 and 9-509, Comment 3. However, under Section 9-509(b), the debtor's authentication of (or becoming bound by) a security agreement *ipso facto* constitutes the debtor's authorization of the filing of a financing statement covering the collateral described in the security agreement. The secured party need not obtain a separate authorization.

Section 9-625 provides a remedy for unauthorized filings. Making an unauthorized filing also may give rise to civil or criminal liability under other law. In addition, this Article contains provisions that assist in the discovery of unauthorized filings and the amelioration of their practical effect. For example, Section 9-518 provides a procedure whereby a person may add to the public record a statement to the effect that a financing statement indexed under the person's name was wrongfully filed, and Section 9-509(d) entitles any person to file a termination statement if the secured party of record fails to

comply with its obligation to file or send one to the debtor, the debtor authorizes the filing, and the termination statement so indicates. However, the filing office is neither obligated nor permitted to inquire into issues of authorization. See Section 9-520(a).

4. **Certain Other Requirements.** Subsection (a) deletes other provisions of former Section 9-402(1) because they seems unwise (real-property description for financing statements covering crops), unnecessary (adequacy of copies of financing statements), or both (copy of security agreement as financing statement). In addition, the filing office must reject a financing statement lacking certain other information formerly required as a condition of perfection (e.g., an address for the debtor or secured party). See Sections 9-516(b), 9-520(a). However, if the filing office accepts the record, it is effective nevertheless. See Section 9-520(c).

5. **Real-Property-Related Filings.** Subsection (b) contains the requirements for financing statements filed as fixture filings and financing statements covering timber to be cut or minerals and minerals-related accounts constituting as-extracted collateral. A description of the related real property must be sufficient to reasonably identify it. See Section 9-108. This formulation rejects the view that the real property description must be by metes and bounds, or otherwise conforming to traditional real-property practice in conveyancing, but, of course, the incorporation of such a description by reference to the recording data of a deed, mortgage or other instrument containing the description should suffice under the most stringent standards. The proper test is that a description of real property must be sufficient so that the financing statement will fit into the real-property search system and be found by a real-property searcher. Under the optional language in subsection (b)(3), the test of adequacy of the description is whether it would be adequate in a record of a mortgage of the real property. As suggested in the Legislative Note, more detail may be required if there is a tract indexing system or a land registration system.

If the debtor does not have an interest of record in the real property, a real-property- related financing statement must show the name of a record owner, and Section 9-519(d) requires the financing statement to be indexed in the name of that owner. This requirement also enables financing statements covering as-extracted collateral or timber to be cut and financing statements filed as fixture filings to fit into the real-property search system.

6. **Record of Mortgage Effective as Financing Statement.** Subsection (c) explains when a record of a mortgage is effective as a financing statement filed as a fixture filing or to cover timber to be cut or as-extracted collateral. Use of the term "record of a mortgage" recognizes that in some systems the record actually filed is not the record pursuant to which a mortgage is created. Moreover, "mortgage" is defined in Section 9-102 as an "interest in real property," not as the record that creates or evidences the mortgage or the record that is filed in the public recording systems. A record creating a mortgage may also create a security interest with respect to fixtures (or other goods) in conformity with this Article. A single agreement creating a mortgage on real property and a security interest in chattels is common and useful for certain purposes. Under subsection (c), the recording of the record evidencing a mortgage (if it satisfies the requirements for a financing statement) constitutes the filing of a financing statement as to the fixtures (but not, of course, as to other goods). Section 9-515(g) makes the usual five-year maximum life for financing statements inapplicable to mortgages that operate as fixture filings under Section 9-502(c). Such mortgages are effective for the duration of the real-property recording.

Of course, if a combined mortgage covers chattels that are not fixtures, a regular financing statement filing is necessary with respect to the chattels, and subsection (c) is inapplicable. Likewise, a financing statement filed as a "fixture filing"is not effective to perfect a security interest in personal property other than fixtures.

In some cases it may be difficult to determine whether goods are or will become fixtures. Nothing in this Part prohibits the filing of a "precautionary" fixture filing, which would provide protection in the event goods are determined to be fixtures. The fact of filing should not be a factor in the determining whether goods are fixtures. Cf. Section 9-505(b).

ANNOTATION

I. General Consideration.
II. Identification of Secured Party.
III. Description of Collateral.

I. GENERAL CONSIDERATION.

Law reviews. For note, "Filing Under the Uniform Commercial Code Act 9", see 38 U. Colo. L. Rev. 598 (1966). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Commercial and Corporate Law", which discusses recent Tenth Circuit decisions dealing with description of collateral in financing statements, see 65 Den. U. L. Rev. 469 (1988).

Annotator's note. Since § 4-9-502 is similar to § 4-9-402 as it existed prior to the 2001

repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

A financing statement does not suffice as a security agreement. John Boyle & Co. v. Colo. Patio & Awning Co., 654 P.2d 335 (Colo. App. 1982).

Financing statement was "signed by the debtor" where purchase agreement signed by purchaser allowed the vendor to sign the financing statement as an agent for the purchaser. NCR Corp. v. Robert A. McNeil Corp., 746 P.2d 1361 (Colo. App. 1987).

Applied in Heinrichsdorff v. Raat, 655 P.2d 860 (Colo. App. 1982).

II. IDENTIFICATION OF SECURED PARTY.

The amendment adopted by the general assembly dispensing with the need of manual signatures should be given effect retroactively because (a) it is procedural and (b) it is curative in nature. In re Colo. Mercantile Co., 299 F. Supp. 55 (D. Colo. 1969).

Perfect accuracy in identification of the secured party on a financing statement is not necessary as long as the statement provides sufficient additional information to enable a prudent examiner to ascertain exact state of affairs through further inquiry. In re Colo. Mercantile Co., 299 F. Supp. 55 (D. Colo. 1969).

A financing statement was not rendered invalid by fact that the financing statement erroneously identified the secured party as "O. M. Scott Credit Corporation" instead of O. M. Scott & Sons Co., since the former corporation was a wholly owned subsidiary of the latter and was so closely related and intertwined with it in business dealings as to be regarded as one with it and since no searching creditor could be seriously misled by the identification of the "O. M. Scott Credit Corporation" as the secured party. In re Colo. Mercantile Co., 299 F. Supp. 55 (D. Colo. 1969).

Invalidating a security interest in the absence of evidence that any creditor was actually so misled would frustrate the liberal intent of the commercial code and would unnecessarily provide a trustee in bankruptcy with a windfall estate at the expense of one creditor. In re Colo. Mercantile Co., 299 F. Supp. 55 (D. Colo. 1969).

III. DESCRIPTION OF COLLATERAL.

Law reviews. For comment on In re Lehner appearing below, see 48 Den. L.J. 146 (1971).

The sufficiency of the description in a financing statement is to be determined by § 4-9-402(1). In re Lehner, 303 F. Supp. 317 (D. Colo. 1969), aff'd per curiam and reh'g denied, 427 F.2d 357 (10th Cir. 1970).

The filing of a financing statement perfects the security interest only if the statement substantially complies with the requirements of § 4-9-402(1). In re Lehner, 303 F. Supp. 317 (D. Colo. 1969), aff'd per curiam and reh'g denied, 427 F.2d 357 (10th Cir. 1970).

Collateral need not be described with utmost particularity. Mountain Credit v. Michiana Lumber & Supply, Inc., 31 Colo. App. 112, 498 P.2d 967 (1972).

The filing need only put other creditors on notice of a possible security interest in the collateral in question, and it is sufficient if the facts of a case show that a third party, assisted by external evidence, could identify the object as being covered by the agreement. Mountain Credit v. Michiana Lumber & Supply, Inc., 31 Colo. App. 112, 498 P.2d 967 (1972).

Since the "notice filing" system adopted by the U.C.C. requires that a secured party provide in public record enough information to alert interested parties that there may be a prior security interest. In re Colo. Mercantile Co., 299 F. Supp. 55 (D. Colo. 1969).

The use of the term "consumer goods" fails to satisfy this section, as it is too broad, general, and meaningless to fulfill the demand of § 4-9-402(1) that the financing statement at least reveal "the types". The description of collateral as simply "consumer goods" is insufficient in that it neither specifies the types nor the items, and where the collateral is used by the owner it would not seem to be an undue hardship to require the lender to designate in more meaningful terms. In re Lehner, 303 F. Supp. 317 (D. Colo. 1969), aff'd per curiam and reh'g denied, 427 F.2d 357 (10th Cir. 1970).

Log-loader sufficiently described. The use of the words "logging equipment and machinery used in logging operations" on one financing statement and the words "new and used equipment for logging and general construction" on another statement sufficiently describes the property so as to create a valid lien on a log-loader. Mountain Credit v. Michiana Lumber & Supply, Inc., 31 Colo. App. 112, 498 P.2d 967 (1972).

Sufficient description of mobile home. Use of the words "floor plans" without other descriptive phrases is not sufficiently specific to describe mobile homes as collateral; however, use of those words in the context "Floor plans of Modular Homes being constructed by Ft. Lupton Builders, 1500 Factory Circle, Ft. Lupton, Colorado 80621" is sufficient notice of a possible security interest in a type of collateral, mobile home units being constructed by Ft. Lupton Builders. Platte Valley Bank v. B & J Constr., Inc., 44 Colo. App. 21, 606 P.2d 455 (1980).

4-9-503. Name of debtor and secured party. (a) A financing statement sufficiently provides the name of the debtor:

(1) If the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the public record of the debtor's jurisdiction of organization which shows the debtor to have been organized;

(2) If the debtor is a decedent's estate, only if the financing statement provides the name of the decedent and indicates that the debtor is an estate;

(3) If the debtor is a trust or a trustee acting with respect to property held in trust, only if the financing statement:

(A) Provides the name specified for the trust in its organic documents or, if no name is specified, provides the name of the settlor and additional information sufficient to distinguish the debtor from other trusts having one or more of the same settlors; and

(B) Indicates, in the debtor's name or otherwise, that the debtor is a trust or is a trustee acting with respect to property held in trust; and

(4) In other cases:

(A) If the debtor has a name, only if it provides the individual or organizational name of the debtor; and

(B) If the debtor does not have a name, only if it provides the names of the partners, members, associates, or other persons comprising the debtor.

Editor's note: This version of subsection (a) is effective until July 1, 2013.

(a) A financing statement sufficiently provides the name of the debtor:

(1) Except as otherwise provided in paragraph (3) of this subsection (a), if the debtor is a registered organization or the collateral is held in a trust that is a registered organization, only if the financing statement provides the name that is stated to be the registered organization's name on the public organic record most recently filed with or issued or enacted by the registered organization's jurisdiction of organization that purports to state, amend, or restate the registered organization's name;

(2) Subject to subsection (f) of this section, if the collateral is being administered by the personal representative of a decedent, only if the financing statement provides, as the name of the debtor, the name of the decedent and, in a separate part of the financing statement, indicates that the collateral is being administered by a personal representative;

(3) If the collateral is held in a trust that is not a registered organization, only if the financing statement:

(A) Provides, as the name of the debtor:

(i) If the organic record of the trust specifies a name for the trust, the name specified; or

(ii) If the organic record of the trust does not specify a name for the trust, the name of the settlor or testator; and

(B) In a separate part of the financing statement:

(i) If the name is provided in accordance with sub-subparagraph (i) of subparagraph (A) of this paragraph (3), indicates that the collateral is held in a trust; or

(ii) If the name is provided in accordance with sub-subparagraph (ii) of subparagraph (A) of this paragraph (3), provides additional information sufficient to distinguish the trust from other trusts having one or more of the same settlors or the same testator and indicates that the collateral is held in a trust, unless the additional information so indicates;

(4) If the debtor is an individual, only if the financing statement:

(A) Provides the individual name of the debtor;

(B) Provides the surname and first personal name of the debtor; or

(C) Subject to subsection (g) of this section, provides the name of the individual that is indicated on a driver's license that this state has issued to the individual and that has not expired; and

(5) In other cases:

(A) If the debtor has a name, only if the financing statement provides the individual or organizational name of the debtor; and

(B) If the debtor does not have a name, only if the financing statement provides the names of the partners, members, associates, or other persons comprising the debtor, in a manner that each name provided would be sufficient if the person named were the debtor.

Editor's note: This version of subsection (a) is effective July 1, 2013.

(b) A financing statement that provides the name of the debtor in accordance with subsection (a) is not rendered ineffective by the absence of:
(1) A trade name or other name of the debtor; or
(2) Unless required under subparagraph (B) of paragraph (4) of subsection (a) of this section, names of partners, members, associates, or other persons comprising the debtor.

Editor's note: This version of subsection (b) is effective until July 1, 2013.

(b) A financing statement that provides the name of the debtor in accordance with subsection (a) of this section is not rendered ineffective by the absence of:
(1) A trade name or other name of the debtor; or
(2) Unless required under subparagraph (B) of paragraph (5) of subsection (a) of this section, names of partners, members, associates, or other persons comprising the debtor.

Editor's note: This version of subsection (b) is effective July 1, 2013.

(c) A financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor.
(d) Failure to indicate the representative capacity of a secured party or representative of a secured party does not affect the sufficiency of a financing statement.
(e) A financing statement may provide the name of more than one debtor and the name of more than one secured party.
(f) The name of the decedent indicated on the order appointing the personal representative of the decedent issued by the court having jurisdiction over the collateral is sufficient as the "name of the decedent" under paragraph (2) of subsection (a) of this section.

Editor's note: Subsection (f) is effective July 1, 2013.

(g) If this state has issued to an individual more than one driver's license of a kind described in subparagraph (C) of paragraph (4) of subsection (a) of this section, the one that was issued most recently is the one to which subparagraph (C) of paragraph (4) of subsection (a) of this section refers.

Editor's note: Subsection (g) is effective July 1, 2013.

(h) In this section, the "name of the settlor or testator" means:
(1) If the settlor is a registered organization, the name that is stated to be the settlor's name on the public organic record most recently filed with or issued or enacted by the settlor's jurisdiction of organization that purports to state, amend, or restate the settlor's name; or
(2) In other cases, the name of the settlor or testator indicated in the trust's organic record.

Editor's note: Subsection (h) is effective July 1, 2013.

Source: L. 2001: Entire article R&RE, p. 1380, § 1, effective July 1. **L. 2012:** (a) and (b) amended and (f), (g), and (h) added, (HB 12-1262), ch. 170, p. 600, § 10, effective July 1, 2013.

OFFICIAL COMMENT

1. **Source.** Subsections (a)(4)(A), (b), and (c) derive from former Section 9-402(7); otherwise, new.
2. **Debtor's Name.** The requirement that a financing statement provide the debtor's name is particularly important. Financing statements are indexed under the name of the debtor, and those who wish to find financing statements search for them under the debtor's name. Subsection (a) explains what the debtor's name is for purposes

of a financing statement. If the debtor is a "registered organization" (defined in Section 9-102 so as to ordinarily include corporations, limited partnerships, and limited liability companies), then the debtor's name is the name shown on the public records of the debtor's "jurisdiction of organization" (also defined in Section 9-102). Subsections (a)(2) and (a)(3) contain special rules for decedent's estates and common-law trusts. (Subsection (a)(1) applies to business trusts that are registered organizations.)

Subsection (a)(4)(A) essentially follows the first sentence of former Section 9-402(7). Section 1-201(28) defines the term "organization," which appears in subsection (a)(4), very broadly, to include all legal and commercial entities as well as associations that lack the status of a legal entity. Thus, the term includes corporations, partnerships of all kinds, business trusts, limited liability companies, unincorporated associations, personal trusts, governments, and estates. If the organization has a name, that name is the correct name to put on a financing statement. If the organization does not have a name, then the financing statement should name the individuals or other entities who comprise the organization.

Together with subsections (b) and (c), subsection (a) reflects the view prevailing under former Article 9 that the actual individual or organizational name of the debtor on a financing statement is both necessary and sufficient, whether or not the financing statement provides trade or other names of the debtor and, if the debtor has a name, whether or not the financing statement provides the names of the partners, members, or associates who comprise the debtor.

Note that, even if the name provided in an initial financing statement is correct, the filing office nevertheless must reject the financing statement if it does not identify an individual debtor's last name (e.g., if it is not clear whether the debtor's name is Perry Mason or Mason Perry). See Section 9-516(b)(3)(C).

Note: This version of paragraph 2. is effective until July 1, 2013.

[2. **Debtor's Name.** The requirement that a financing statement provide the debtor's name is particularly important. Financing statements are indexed under the name of the debtor, and those who wish to find financing statements search for them under the debtor's name. Subsection (a) explains what the debtor's name is for purposes of a financing statement.]

[a. **Registered Organizations.** As a general matter, if the debtor is a "registered organization" (defined in Section 9-102 so as to ordinarily include corporations, limited partnerships, limited liability companies, and statutory trusts), then the debtor's name is the name shown on the "public organic record" of the debtor's "jurisdiction of organization" (both also defined in Section 9-102).]

[b. **Collateral Held in a Trust.** When a financing statement covers collateral that is held in a trust that is a registered organization, subsection (a)(1) governs the name of the debtor. If, however, the collateral is held in a trust that is not a registered organization, subsection (a)(3) applies. (As used in this Article, collateral "held in a trust" includes collateral as to which the trust is the debtor as well as collateral as to which the trustee is the debtor.) This subsection adopts a convention that generally results in the name of the trust or the name of the trust's settlor being provided as the name of the debtor on the financing statement, even if, as typically is the case with common-law trusts, the "debtor" (defined in Section 9-102) is a trustee acting with respect to the collateral. This convention provides more accurate information and eases the burden for searchers, who otherwise would have difficulty with respect to debtor trustees that are large financial institutions.]

[More specifically, if a trust's organic record specifies a name for the trust, subsection (a)(3) requires the financing statement to provide, as the name of the debtor, the name for the trust specified in the organic record. In addition, the financing statement must indicate, in a separate part of the financing statement, that the collateral is held in a trust.]

[If the organic record of the trust does not specify a name for the trust, the name required for the financing statement is the name of the settlor or, in the case of a testamentary trust, the testator, in each case as determined under subsection (h). In addition, the financing statement must provide sufficient additional information to distinguish the trust from other trusts having one or more of the same settlors or the same testator. In many cases an indication of the date on which the trust was settled will satisfy this requirement. If neither the name nor the additional information indicates that the collateral is held in a trust, the financing statement must indicate that fact, but not as part of the debtor's name.]

[Neither the indication that the collateral is held in a trust nor the additional information that distinguishes the trust from other trusts having one or more of the same settlors or the same testator is part of the debtor's name. Nevertheless, a financing statement that fails to provide, in a separate part of the financing statement, any required indication or additional information does not sufficiently provide the name of the debtor under Sections 9-502(a) and 9-503(a)(3), does not "substantially satisfy[ ] the requirements" of Part 5 within the meaning of Section 9-506(a), and so is ineffective.]

[c. **Collateral Administered by a Personal Representative.** Subsection (a)(2) deals with collateral that is being administered by an executor, administrator, or other personal representative of a decedent. Even if, as often is the case, the representative is the "debtor" (defined in

Section 9-102), the financing statement must provide the name of the decedent as the name of the debtor. Subsection (f) provides a safe harbor, under which the name of the decedent indicated on the order appointing the personal representative issued by the court having jurisdiction over the collateral is sufficient as the name of the decedent. If the order indicates more than one name for the decedent, the first name in the list qualifies under subsection (f); however, other names in the list also may qualify as the "name of the decedent" within the meaning of subsection (a)(2). In addition to providing the name of the decedent, the financing statement must indicate, in a separate part of the financing statement, that the collateral is being administered by a personal representative. Although the indication is not part of the debtor's name, a financing statement that fails to provide the indication does not sufficiently provide the name of the debtor under Sections 9-502(a) and 9-503(a)(2), does not "substantially satisfy[ ] the requirements" of Part 5 within the meaning of Section 9- 506(a), and so is ineffective.]

[d. **Individuals.** This Article provides alternative approaches towards the requirement for providing the name of a debtor who is an individual.]

[*Alternative A.* Alternative A distinguishes between two groups of individual debtors. For debtors holding an unexpired driver's license issued by the State where the financing statement is filed (ordinarily the State where the debtor maintains the debtor's principal residence), Alternative A requires that a financing statement provide the name indicated on the license. When a debtor does not hold an unexpired driver's license issued by the relevant State, the requirement can be satisfied in either of two ways. A financing statement is sufficient if it provides the "individual name" of the debtor. Alternatively, a financing statement is sufficient if it provides the debtor's surname (i.e., family name) and first personal name (i.e., first name other than the surname).]

[*Alternative B.* Alternative B provides three ways in which a financing statement may sufficiently provide the name of an individual who is a debtor. The "individual name" of the debtor is sufficient, as is the debtor's surname and first personal name. If the individual holds an unexpired driver's license issued by the State where the financing statement is filed (ordinarily the State of the debtor's principal residence), the name indicated on the driver's license also is sufficient.]

[*Name indicated on the driver's license.* A financing statement does not "provide the name of the individual which is indicated" on the debtor's driver's license unless the name it provides is the same as the name indicated on the license. This is the case even if the name indicated on the debtor's driver's license contains an error.]

[**Example 1:** Debtor, an individual whose principal residence is in Illinois, grants a security interest to SP in certain business equipment. SP files a financing statement with the Illinois filing office. The financing statement provides the name appearing on Debtor's Illinois driver's license, "Joseph Allan Jones." Regardless of which Alternative is in effect in Illinois, this filing would be sufficient under Illinois' Section 9-503(a), even if Debtor's correct middle name is Alan, not Allan.]

[A filing against "Joseph A. Jones" or "Joseph Jones" would not "provide the name of the individual which is indicated" on the debtor's driver's license. However, these filings might be sufficient if Alternative A is in effect in Illinois and Jones has no current (i.e., unexpired) Illinois driver's license, or if Illinois has enacted Alternative B.]

[Determining the name that should be provided on the financing statement must not be done mechanically. The order in which the components of an individual's name appear on a driver's license differs among the States. Had the debtor in Example 1 obtained a driver's license from a different State, the license might have indicated the name as "Jones Joseph Allan." Regardless of the order on the driver's license, the debtor's surname must be provided in the part of the financing statement designated for the surname.]

[Alternatives A and B both refer to a license issued by "this State." Perfection of a security interest by filing ordinarily is determined by the law of the jurisdiction in which the debtor is located. See Section 9-301(1). (Exceptions to the general rule are found in Section 9-301(3) and (4), concerning fixture filings, timber to be cut, and as-extracted collateral.) A debtor who is an individual ordinarily is located at the individual's principal residence. See Section 9-307(b). (An exception appears in Section 9-307(c).) Thus, a given State's Section 9-503 ordinarily will apply during any period when the debtor's principal residence is located in that State, even if during that time the debtor holds or acquires a driver's license from another State.]

[When a debtor's principal residence changes, the location of the debtor under Section 9-307 also changes and perfection by filing ordinarily will be governed by the law of the debtor's new location. As a consequence of the application of that jurisdiction's Section 9-316, a security interest that is perfected by filing under the law of the debtor's former location will remain perfected for four months after the relocation, and thereafter if the secured party perfects under the law of the debtor's new location. Likewise, a financing statement filed in the former location may be effective to perfect a

security interest that attaches after the debtor relocates. See Section 9-316(h).]

[*Individual name of the debtor.* Article 9 does not determine the "individual name" of a debtor. Nor does it determine which element or elements in a debtor's name constitute the surname. In some cases, determining the "individual name" of a debtor may be difficult, as may determining the debtor's surname. This is because in the case of individuals, unlike registered organizations, there is no public organic record to which reference can be made and from which the name and its components can be definitively determined.]

[Names can take many forms in the United States. For example, whereas a surname is often colloquially referred to as a "last name," the sequence in which the elements of a name are presented is not determinative. In some cultures, the surname appears first, while in others it may appear in a location that is neither first nor last. In addition, some surnames are composed of multiple elements that, taken together, constitute a single surname. These elements may or may not be separated by a space or connected by a hyphen, "i," or "y." In other instances, some or all of the same elements may not be part of the surname. In some cases, a debtor's entire name might be composed of only a single element, which should be provided in the part of the financing statement designated for the surname.]

[In disputes as to whether a financing statement sufficiently provides the "individual name" of a debtor, a court should refer to any non-UCC law concerning names. However, case law about names may have developed in contexts that implicate policies different from those of Article 9. A court considering an individual's name for purposes of determining the sufficiency of a financing statement is not necessarily bound by cases that were decided in other contexts and for other purposes.]

[Individuals are asked to provide their names on official documents such as tax returns and bankruptcy petitions. An individual may provide a particular name on an official document in response to instructions relating to the document rather than because the name is actually the individual's name. Accordingly, a court should not assume that the name an individual provides on an official document necessarily constitutes the "individual name" for purposes of the sufficiency of the debtor's name on a financing statement. Likewise, a court should not assume that the name as presented on an individual's birth certificate is necessarily the individual's current name.]

[In applying non-UCC law for purposes of determining the sufficiency of a debtor's name on a financing statement, a court should give effect to the instruction in Section 1-103(a)(1) that the UCC "must be liberally construed and applied to promote its underlying purposes and policies," which include simplifying and clarifying the law governing commercial transactions. Thus, determination of a debtor's name in the context of the Article 9 filing system must take into account the needs of both filers and searchers. Filers need a simple and predictable system in which they can have a reasonable degree of confidence that, without undue burden, they can determine a name that will be sufficient so as to permit their financing statements to be effective. Likewise, searchers need a simple and predictable system in which they can have a reasonable degree of confidence that, without undue burden, they will discover all financing statements pertaining to the debtor in question. The court also should take into account the purpose of the UCC to make the law uniform among the various jurisdictions. See Section 1-103(a)(3).]

[Of course, once an individual debtor's name has been determined to be sufficient for purposes of Section 9-503, a financing statement that provides a variation of that name, such as a "nickname" that does not constitute the debtor's name, does not sufficiently provide the name of the debtor under this section. Cf. Section 9-503(c) (a financing statement providing only a debtor's trade name is not sufficient).]

[If there is any doubt about an individual debtor's name, a secured party may choose to file one or more financing statements that provide a number of possible names for the debtor and a searcher may similarly choose to search under a number of possible names.]

Note that, even if the name provided in an initial financing statement is correct, the filing office nevertheless must reject the financing statement if it does not identify an individual debtor's surname (e.g., if it is not clear whether the debtor's surname is Perry or Mason). See Section 9-516(b)(3)(C).

Note: This version of paragraph 2. is effective July 1, 2013.

3. **Secured Party's Name.** New subsection (d) makes clear that when the secured party is a representative, a financing statement is sufficient if it names the secured party, whether or not it indicates any representative capacity. Similarly, a financing statement that names a representative of the secured party is sufficient, even if it does not indicate the representative capacity.

Example [2]: Debtor creates a security interest in favor of Bank X, Bank Y, and Bank Z, but not to their representative, the collateral agent (Bank A). The collateral agent is not itself a secured party. See Section 9-102. Under Sections 9-502(a) and 9- 503(d), however, a financing statement is effective if it names as secured party Bank A and not the actual secured parties, even if it omits Bank A's representative capacity.

Note: The bracketed language takes effect July 1, 2013.

Each person whose name is provided in an initial financing statement as the name of the secured party or representative of the secured party is a secured party of record. See Section 9-511.

4. **Multiple Names.** Subsection (e) makes explicit what is implicit under former Article 9: a financing statement may provide the name of more than one debtor and secured party. See Section 1-102(5)(a) (words in the singular include the plural). With respect to records relating to more than one debtor, see Section 9-520(d). With respect to financing statements providing the name of more than one secured party, see Sections 9-509(e) and 9-510(b).

Note: "1-102(5)(a)" will be replaced with "1-106" effective July 1, 2013.

4-9-504. Indication of collateral. A financing statement sufficiently indicates the collateral that it covers if the financing statement provides:

(1) A description of the collateral pursuant to section 4-9-108; or

(2) An indication that the financing statement covers all assets or all personal property.

Source: L. 2001: Entire article R&RE, p. 1381, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-402 (1) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-402(1).

2. **Indication of Collateral.** To comply with Section 9-502(a), a financing statement must "indicate" the collateral it covers. A financing statement sufficiently indicates collateral claimed to be covered by the financing statement if it satisfies the purpose of conditioning perfection on the filing of a financing statement, i.e., if it provides notice that a person may have a security interest in the collateral claimed. See Section 9-502, Comment 2. In particular, an indication of collateral that would have satisfied the requirements of former Section 9-402(1) (i.e., "a statement indicating the types, or describing the items, of collateral") suffices under Section 9-502(a). An indication may satisfy the requirements of Section 9-502(a), even if it would not have satisfied the requirements of former Section 9-402(1).

This section provides two safe harbors. Under paragraph (1), a "description" of the collateral (as the term is explained in Section 9-108) suffices as an indication for purposes of the sufficiency of a financing statement.

Debtors sometimes create a security interest in all, or substantially all, of their assets. To accommodate this practice, paragraph (2) expands the class of sufficient collateral references to embrace "an indication that the financing statement covers all assets or all personal property." If the property in question belongs to the debtor and is personal property, any searcher will know that the property is covered by the financing statement. Of course, regardless of its breadth, a financing statement has no effect with respect to property indicated but to which a security interest has not attached. Note that a broad statement of this kind (e.g., "all debtor's personal property") would not be a sufficient "description" for purposes of a security agreement. See Sections 9-203(b)(3)(A), 9-108. It follows that a somewhat narrower description than "all assets," e.g., "all assets other than automobiles," is sufficient for purposes of this section, even if it does not suffice for purposes of a security agreement.

ANNOTATION

Law reviews. For note, "Filing Under the Uniform Commercial Code Act 9", see 38 U. Colo. L. Rev. 598 (1966). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Commercial and Corporate Law", which discusses recent Tenth Circuit decisions dealing with description of collateral in financing statements, see 65 Den. U. L. Rev. 469 (1988).

Annotator's note. Section 4-9-504 is similar to § 4-9-402 as it existed prior to the 2001 repeal and reenactment of this article. Relevant cases construing § 4-9-402 have been included in the annotations to § 4-9-502.

4-9-505. Filing and compliance with other statutes and treaties for consignments, leases, other bailments, and other transactions. (a) A consignor, lessor, or other bailor of goods, a licensor, or a buyer of a payment intangible or promissory note may file a

financing statement, or may comply with a statute or treaty described in section 4-9-311 (a), using the terms "consignor", "consignee", "lessor", "lessee", "bailor", "bailee", "licensor", "licensee", "owner", "registered owner", "buyer", "seller", or words of similar import, instead of the terms "secured party" and "debtor".

(b) This part 5 applies to the filing of a financing statement under subsection (a) of this section and, as appropriate, to compliance that is equivalent to filing a financing statement under section 4-9-311 (b), but the filing or compliance is not of itself a factor in determining whether the collateral secures an obligation. If it is determined for another reason that the collateral secures an obligation, a security interest held by the consignor, lessor, bailor, licensor, owner, or buyer which attaches to the collateral is perfected by the filing or compliance.

Source: L. 2001: Entire article R&RE, p. 1381, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-408 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-408.

2. **Precautionary Filing.** Occasionally, doubts arise concerning whether a transaction creates a relationship to which this Article or its filing provisions apply. For example, questions may arise over whether a "lease" of equipment in fact creates a security interest or whether the "sale" of payment intangibles in fact secures an obligation, thereby requiring action to perfect the security interest. This section, which derives from former Section 9-408, affords the option of filing of a financing statement with appropriate changes of terminology but without affecting the substantive question of classification of the transaction.

3. **Changes from Former Section 9-408.** This section expands the rule of [former] Section 9-408 to embrace more generally other bailments and transactions, as well as sales transactions, primarily sales of payment intangibles and promissory notes. It provides the same benefits for compliance with a statute or treaty described in Section 9-311(a) that former Section 9-408 provided for filing, in connection with the use of terms such as "lessor," consignor," etc. The references to "owner" and "registered owner" are intended to address, for example, the situation where a putative lessor is the registered owner of an automobile covered by a certificate of title and the transaction is determined to create a security interest. Although this section provides that the security interest is perfected, the relevant certificate-of-title statute may expressly provide to the contrary or may be ambiguous. If so, it may be necessary or advisable to amend the certificate-of-title statute to ensure that perfection of the security interest will be achieved.

Note: The bracketed language takes effect July 1, 2013.

As does Section 1-201, former Article 9 referred to transactions, including leases and consignments, "intended as security." This misleading phrase created the erroneous impression that the parties to a transaction can dictate how the law will classify it (e.g., as a bailment or as a security interest) and thus affect the rights of third parties. This Article deletes the phrase wherever it appears. Subsection (b) expresses the principle more precisely by referring to a security interest that "secures an obligation."

Note: In the first sentence "does" will be replaced with "did former" effective July 1, 2013.

4. **Consignments.** Although a "true" consignment is a bailment, the filing and priority provisions of former Article 9 applied to "true" consignments. See former Sections 2-326(3), 9-114. A consignment "intended as security" created a security interest that was in all respects subject to former Article 9. This Article subsumes most true consignments under the rubric of "security interest." See Sections 9-102 (definition of "consignment"), 9-109(a)(4), 1-201(37) (definition of "security interest"). Nevertheless, it maintains the distinction between a (true) "consignment," as to which only certain aspects of Article 9 apply, and a so-called consignment that actually "secures an obligation," to which Article 9 applies in full. The revisions to this section reflect the change in terminology.

Note:"1-201(37)" will be replaced with "1-201(b)(35)" effective July 1, 2013.

4-9-506. Effect of errors or omissions. (a) A financing statement substantially satisfying the requirements of this part 5 is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading.

(b) Except as otherwise provided in subsection (c) of this section, a financing statement that fails sufficiently to provide the name of the debtor in accordance with section 4-9-503 (a) is seriously misleading.

(c) If a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with section 4-9-503 (a), the name provided does not make the financing statement seriously misleading.

(d) For purposes of section 4-9-508 (b), the "debtor's correct name" in subsection (c) of this section means the correct name of the new debtor.

Source: L. 2001: Entire article R&RE, p. 1381, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-402 (8) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-402(8).

2. **Errors [and Omissions.]** Like former Section 9-402(8), subsection (a) is in line with the policy of this Article to simplify formal requisites and filing requirements. It is designed to discourage the fanatical and impossibly refined reading of statutory requirements in which courts occasionally have indulged themselves. Subsection (a) provides the standard applicable to indications of collateral. Subsections (b) and (c), which are new, concern the effectiveness of financing statements in which the debtor's name is incorrect. Subsection (b) contains the general rule: a financing statement that fails sufficiently to provide the debtor's name in accordance with Section 9-503(a) is seriously misleading as a matter of law. Subsection (c) provides an exception: If the financing statement nevertheless would be discovered in a search under the debtor's correct name, using the filing office's standard search logic, if any, then as a matter of law the incorrect name does not make the financing statement seriously misleading. A financing statement that is seriously misleading under this section is ineffective even if it is disclosed by (i) using a search logic other than that of the filing office to search the official records, or (ii) using the filing office's standard search logic to search a data base other than that of the filing office. [For purposes of subsection (c), any name that satisfies Section 9-503(a) at the time of the search is a "correct name."]

Note: The bracketed language takes effect July 1, 2013.

[This section and Section 9-503 balance the interests of filers and searchers. Searchers are not expected to ascertain nicknames, trade names, and the like by which the debtor may be known and then search under each of them. Rather, it is the secured party's responsibility to provide the name of the debtor sufficiently in a filed financing statement. Subsection (c) sets forth the only situation in which a financing statement that fails sufficiently to provide the name of the debtor is not seriously misleading. As stated in subsection (b), if the name of the debtor provided on a financing statement is insufficient and subsection (c) is not satisfied, the financing statement is seriously misleading. Such a financing statement is ineffective even if the debtor is known in some contexts by the name provided on the financing statement and even if searchers know or have reason to know that the name provided on the financing statement refers to the debtor. Any suggestion to the contrary in a judicial opinion is incorrect.]

Note: The bracketed language takes effect July 1, 2013.

[To satisfy the requirements of Section 9-503(a)(2), a financing statement must indicate that the collateral is being administered by a personal representative. To satisfy the requirements of Section 9-503(a)(3), a financing statement must indicate that the collateral is held in a trust and provide additional information that distinguishes the trust from certain other trusts. The indications and additional information are not part of the debtor's name. Nevertheless, a financing statement that fails to provide an indication or the additional information when required does not sufficiently provide the name of the debtor under Sections 9-502(a) and 9-503(a), does not "substantially satisfy[ ] the requirements" of Part 5 within the meaning of this section and so is ineffective.]

Note: The bracketed language takes effect July 1, 2013.

In addition to requiring the debtor's name and an indication of the collateral, Section 9-502(a) requires a financing statement to provide the name of the secured party or a representative of the secured party. Inasmuch as searches are not conducted under the secured party's name, and no filing is needed to continue the perfected status of security interest after it is assigned, an error in the name of the secured party or its representative will not be seriously misleading. However, in an appropriate case, an error of this kind may give rise to an estoppel in favor of a particular holder of a conflicting claim to the collateral. See Section 1-103.

3. **New Debtors.** Subsection (d) provides that, in determining the extent to which a financing statement naming an original debtor is effective against a new debtor, the sufficiency of the financing statement should be tested against the name of the new debtor.

ANNOTATION

Law reviews. For note, "Filing Under the Uniform Commercial Code Act 9", see 38 U. Colo. L. Rev. 598 (1966). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Commercial and Corporate Law", which discusses recent Tenth Circuit decisions dealing with description of collateral in financing statements, see 65 Den. U. L. Rev. 469 (1988).

Annotator's note. Section 4-9-506 is similar to § 4-9-402 as it existed prior to the 2001 repeal and reenactment of this article. Relevant cases construing § 4-9-402 have been included in the annotations to § 4-9-502.

4-9-507. Effect of certain events on effectiveness of financing statement. (a) A filed financing statement remains effective with respect to collateral that is sold, exchanged, leased, licensed, or otherwise disposed of and in which a security interest or agricultural lien continues, even if the secured party knows of or consents to the disposition.

(b) Except as otherwise provided in subsection (c) of this section and section 4-9-508, a financing statement is not rendered ineffective if, after the financing statement is filed, the information provided in the financing statement becomes seriously misleading under section 4-9-506.

(c) If a debtor so changes its name that a filed financing statement becomes seriously misleading under section 4-9-506:

(1) The financing statement is effective to perfect a security interest in collateral acquired by the debtor before, or within four months after, the change; and

(2) The financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless an amendment to the financing statement which renders the financing statement not seriously misleading is filed within four months after the change.

Editor's note: This version of subsection (c) is effective until July 1, 2013.

(c) If the name that a filed financing statement provides for a debtor becomes insufficient as the name of the debtor under section 4-9-503 (a) so that the financing statement becomes seriously misleading under section 4-9-506:

(1) The financing statement is effective to perfect a security interest in collateral acquired by the debtor before, or within four months after, the filed financing statement becomes seriously misleading; and

(2) The financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the filed financing statement becomes seriously misleading, unless an amendment to the financing statement that renders the financing statement not seriously misleading is filed within four months after the filed financing statement becomes seriously misleading.

Editor's note: This version of subsection (c) is effective July 1, 2013.

Source: L. 2001: Entire article R&RE, p. 1382, § 1, effective July 1. **L. 2012:** (c) amended, (HB 12-1262), ch. 170, p. 602, § 11, effective July 1, 2013.

Editor's note: This section is similar to former § 4-9-402 (7) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-402(7).
2. **Scope of Section.** This section deals with situations in which the information in a proper financing statement becomes inaccurate after the financing statement is filed. Compare Section 9-338, which deals with situations in which a financing statement contains a particular kind of information concerning the debtor (i.e., the in-

formation described in Section 9-516(b)(5)) that is incorrect at the time it is filed.

3. **Post-Filing Disposition of Collateral.** Under subsection (a), a financing statement remains effective even if the collateral is sold or otherwise disposed of. This subsection clarifies the third sentence of former Section 9-402(7) by providing that a financing statement remains effective following the disposition of collateral only when the security interest or agricultural lien continues in that collateral. This result is consistent with the conclusion of PEB Commentary No. 3. Normally, a security interest does continue after disposition of the collateral. See Section 9-315(a). Law other than this Article determines whether an agricultural lien survives disposition of the collateral.

As a consequence of the disposition, the collateral may be owned by a person other than the debtor against whom the financing statement was filed. Under subsection (a), the secured party remains perfected even if it does not correct the public record. For this reason, any person seeking to determine whether a debtor owns collateral free of security interests must inquire as to the debtor's source of title and, if circumstances seem to require it, search in the name of a former owner. Subsection (a) addresses only the sufficiency of the information contained in the financing statement. A disposition of collateral may result in loss of perfection for other reasons. See Section 9-316.

Example: Dee Corp. is an Illinois corporation. It creates a security interest in its equipment in favor of Secured Party. Secured Party files a proper financing statement in Illinois. Dee Corp. sells an item of equipment to Bee Corp., a Pennsylvania corporation, subject to the security interest. The security interest continues, see Section 9-315(a), and remains perfected, see Section 9-507(a), notwithstanding that the financing statement is filed under "D" (for Dee Corp.) and not under "B." However, because Bee Corp. is located in Pennsylvania and not Illinois, see Section 9-307, unless Secured Party perfects under Pennsylvania law within one year after the transfer, its security interest will become unperfected and will be deemed to have been unperfected against purchasers of the collateral. See Section 9-316.

4. **Other Post-Filing Changes.** Subsection (b) provides that, as a general matter, post-filing changes that render a financing statement inaccurate and seriously misleading have no effect on a financing statement. The financing statement remains effective. It is subject to two exceptions: Section 9-508 and Section 9-507(c). Section 9-508 addresses the effectiveness of a financing statement filed against an original debtor when a new debtor becomes bound by the original debtor's security agreement. It is discussed in the Comments to that section. Section 9-507(c) addresses a "pure" change of the debtor's name, i.e., a change that does not implicate a new debtor. It clarifies former Section 9-402(7). If a name change renders a filed financing statement seriously misleading, the financing statement, unless amended to provide the debtor's new correct name, is effective only to perfect a security interest in collateral acquired by the debor before, or within four months after, the change. If an amendment that provides the new correct name is filed within four months after the change, the financing statement as amended would be effective also with respect to collateral acquired more than four months after the change. If an amendment that provides the new correct name is filed more than four months after the change, the financing statement as amended would be effective also with respect to collateral acquired more than four months after the change, but only from the time of the filing of the amendment.

Note: This version of this paragraph 4. is effective until July 1, 2013.

[4.**Other Post-Filing Changes.** Subsection (b) provides that, as a general matter, post-filing changes that render a financing statement seriously misleading have no effect on a financing statement. The financing statement remains effective. It is subject to two exceptions: Section 9-508 and Section 9-507(c). Section 9-508 addresses the effectiveness of a financing statement filed against an original debtor when a new debtor becomes bound by the original debtor's security agreement. It is discussed in the Comments to that section. Section 9-507(c) addresses cases in which a filed financing statement provides a name that, at the time of filing, satisfies the requirements of Section 9-503(a) with respect to the named debtor but, at a later time, no longer does so.]

[**Example 1:** Debtor, an individual whose principal residence is in California, grants a security interest to SP in certain business equipment. SP files a financing statement with the California filing office. Alternative A is in effect in California. The financing statement provides the name appearing on Debtor's California driver's license, "James McGinty." Debtor obtains a court order changing his name to "Roger McGuinn" but does not change his driver's license. Even after the court order issues, the name provided for the debtor in the financing statement is sufficient under Section 9-503(a).]

[Accordingly, Section 9-507(c) does not apply.]

[The same result would follow if Alternative B is in effect in California.]

[Under Section 9-503(a)(4) (Alternative A), if the debtor holds a current (i.e., unexpired) driver's license issued by the State where the financing statement is filed, the name required for the financing statement is the name indicated on the license that was issued most recently by that State. If the debtor does not have a current

driver's license issued by that State, then the debtor's name is determined under subsection (a)(5). It follows that a debtor's name may change, and a financing statement providing the name on the debtor's then-current driver's license may become seriously misleading, if the license expires and the debtor's name under subsection (a)(5) is different. The same consequences may follow if a debtor's driver's license is renewed and the names on the licenses differ.]

[**Example 2:** The facts are as in Example 1. Debtor's driver's license expires one year after the entry of the court order changing Debtor's name. Debtor does not renew the license. Upon expiration of the license, the name required for sufficiency by Section 9-503(a) is the individual name of the debtor or the debtor's surname and first personal name. The name "James McGinty" has become insufficient.]

[**Example 3:** The facts are as in Example 1. Before the license expires, Debtor renews the license. The name indicated on the new license is "Roger McGuinn." Upon issuance of the new license, "James McGinty" becomes insufficient as the debtor's name under Section 9-503(a).]

[The same results would follow if Alternative B is in effect in California (assuming that, following the issuance of the court order, "James McGinty" is neither the individual name of the debtor nor the debtor's surname and first personal name).]

[Even if the name provided as the name of the debtor becomes insufficient under Section 9-503(a), the filed financing statement does not become seriously misleading, and Section 9-507(c) does not apply, if the financing statement can be found by searching under the debtor's "correct" name, using the filing office's standard search logic. See Section 9-506. Any name that satisfies Section 9-503(a) at the time of the search is a "correct name" for these purposes. Thus, assuming that a search of the records of the California filing office under "Roger McGuinn," using the filing office's standard search logic, would not disclose a financing statement naming "James McGinty," the financing statement in Examples 2 and 3 has become seriously misleading and Section 9-507(c) applies.]

[If a filed financing statement becomes seriously misleading because the name it provides for a debtor becomes insufficient, the financing statement, unless amended to provide a sufficient name for the debtor, is effective only to perfect a security interest in collateral acquired by the debtor before, or within four months after, the change. If an amendment that provides a sufficient name is filed within four months after the change, the financing statement as amended would be effective also with respect to collateral acquired more than four months after the change. If an amendment that provides a sufficient name is filed more than four months after the change, the financing statement as amended would be effective also with respect to collateral acquired more than four months after the change, but only from the time of the filing of the amendment.]

Note: This version of this paragraph 4. is effective July 1, 2013.

ANNOTATION

Law reviews. For note, "Filing Under the Uniform Commercial Code Act 9", see 38 U. Colo. L. Rev. 598 (1966). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Commercial and Corporate Law", which discusses recent Tenth Circuit decisions dealing with description of collateral in financing statements, see 65 Den. U. L. Rev. 469 (1988).

Annotator's note. Section 4-9-507 is similar to § 4-9-402 as it existed prior to the 2001 repeal and reenactment of this article. Relevant cases construing § 4-9-402 have been included in the annotations to § 4-9-502.

4-9-508. Effectiveness of financing statement if new debtor becomes bound by security agreement. (a) Except as otherwise provided in this section, a filed financing statement naming an original debtor is effective to perfect a security interest in collateral in which a new debtor has or acquires rights to the extent that the financing statement would have been effective had the original debtor acquired rights in the collateral.

(b) If the difference between the name of the original debtor and that of the new debtor causes a filed financing statement that is effective under subsection (a) of this section to be seriously misleading under section 4-9-506:

(1) The financing statement is effective to perfect a security interest in collateral acquired by the new debtor before, and within four months after, the new debtor becomes bound under section 4-9-203 (d); and

(2) The financing statement is not effective to perfect a security interest in collateral acquired by the new debtor more than four months after the new debtor becomes bound

under section 4-9-203 (d) unless an initial financing statement providing the name of the new debtor is filed before the expiration of that time.

(c) This section does not apply to collateral as to which a filed financing statement remains effective against the new debtor under section 4-9-507 (a).

Source: L. 2001: Entire article R&RE, p. 1382, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **The Problem.** Section 9-203(d) and (e) and this section deal with situations where one party (the "new debtor") becomes bound as debtor by a security agreement entered into by another person (the "original debtor"). These situations often arise as a consequence of changes in business structure. For example, the original debtor may be an individual debtor who operates a business as a sole proprietorship and then incorporates it. Or, the original debtor may be a corporation that is merged into another corporation. Under both former Article 9 and this Article, collateral that is transferred in the course of the incorporation or merger normally would remain subject to a perfected security interest. See Sections 9-315(a), 9-507(a). Former Article 9 was less clear with respect to whether an after-acquired property clause in a security agreement signed by the original debtor would be effective to create a security interest in property acquired by the new corporation or the merger survivor and, if so, whether a financing statement filed against the original debtor would be effective to perfect the security interest. This section and Sections 9-203(d) and (e) are a clarification.

3. **How New Debtor Becomes Bound.** Normally, a security interest is unenforceable unless the debtor has authenticated a security agreement describing the collateral. See Section 9-203(b). New Section 9-203(e) creates an exception, under which a security agreement entered into by one person is effective with respect to the property of another. This exception comes into play if a "new debtor" becomes bound as debtor by a security agreement entered into by another person (the "original debtor"). (The quoted terms are defined in Section 9-102.) If a new debtor does become bound, then the security agreement entered into by the original debtor satisfies the security-agreement requirement of Section 9-203(b)(3) as to existing or after-acquired property of the new debtor to the extent the property is described in the security agreement. In that case, no other agreement is necessary to make a security interest enforceable in that property. See Section 9-203(e).

Section 9-203(d) explains when a new debtor becomes bound by an original debtor's security agreement. Under Section 9-203(d)(1), a new debtor becomes bound as debtor if, by contract or operation of other law, the security agreement becomes effective to create a security interest in the new debtor's property. For example, if the applicable corporate law of mergers provides that when A Corp merges into B Corp, B Corp becomes a debtor under A Corp's security agreement, then B Corp would become bound as debtor following such a merger. Similarly, B Corp would become bound as debtor if B Corp contractually assumes A's obligations under the security agreement.

Under certain circumstances, a new debtor becomes bound for purposes of this Article even though it would not be bound under other law. Under Section 9-203(d)(2), a new debtor becomes bound when, by contract or operation of other law, it (i) becomes obligated not only for the secured obligation but also generally for the obligations of the original debtor and (ii) acquires or succeeds to substantially all the assets of the original debtor. For example, some corporate laws provide that, when two corporations merge, the surviving corporation succeeds to the assets of its merger partner and "has all liabilities" of both corporations. In the case where, for example, A Corp merges into B Corp (and A Corp ceases to exist), some people have questioned whether A Corp's grant of a security interest in its existing and after-acquired property becomes a "liability" of B Corp, such that B Corp's existing and after-acquired property becomes subject to a security interest in favor of A Corp's lender. Even if corporate law were to give a negative answer, under Section 9-203(d)(2), B Corp would become bound for purposes of Section 9-203(e) and this section. The "substantially all of the assets" requirement of Section 9-203(d)(2) excludes sureties and other secondary obligors as well as persons who become obligated through veil piercing and other non-successorship doctrines. In most cases, it will exclude successors to the assets and liabilities of a division of a debtor.

4. **When Financing Statement Effective Against New Debtor.** Subsection (a) provides that a filing against the original debtor generally is effective to perfect a security interest in collateral that a new debtor has at the time it becomes bound by the original debtor's security agreement and collateral that it acquires after the new debtor becomes bound. Under subsection (b), however, if the filing against the original debtor is seriously misleading as to the new debtor's name, the filing is effective as to col-

lateral acquired by the new debtor more than four months after the new debtor becomes bound only if a person files during the four-month period an initial financing statement providing the name of the new debtor. Compare Section 9-507(c) (four-month period of effectiveness with respect to collateral acquired by a debtor after the debtor changes its name). Moreover, if the original debtor and the new debtor are located in different jurisdictions, a filing against the original debtor would not be effective to perfect a security interest in collateral that the new debtor acquires or has acquired from a person other than the original debtor. See Example 5, Section 9-316, Comment 2.

Note: This version of this paragraph 4. is effective until July 1, 2013.

4.**When Financing Statement Effective Against New Debtor.** Subsection (a) provides that a filing against the original debtor generally is effective to perfect a security interest in collateral that a new debtor has at the time it becomes bound by the original debtor's security agreement and collateral that it acquires after the new debtor becomes bound. Under subsection (b), however, if the filing against the original debtor is seriously misleading as to the new debtor's name, the filing is effective as to collateral acquired by the new debtor more than four months after the new debtor becomes bound only if a person files during the four-month period an initial financing statement providing the name of the new debtor. Compare Section 9-507(c) (four-month period of effectiveness with respect to collateral acquired by a debtor after the name provided for the debtor becomes insufficient as the name of the debtor). As to the meaning of "initial financing statement" in this context, see Section 9-512, Comment 5.

Note: This version of this paragraph 4. is effective July 1, 2013.

5. **Transferred Collateral.** This section does not apply to collateral transferred by the original debtor to a new debtor. See subsection (c). Under those circumstances, the filing against the original debtor continues to be effective until it lapses or perfection is lost for another reason. See Sections 9-316, 9-507(a).

6. **Priority.** Section 9-326 governs the priority contest between a secured creditor of the original debtor and a secured creditor of the new debtor.

4-9-509. Persons entitled to file a record. (a) A person may file an initial financing statement, amendment that adds collateral covered by a financing statement, or amendment that adds a debtor to a financing statement only if:

(1) The debtor authorizes the filing in an authenticated record or pursuant to subsection (b) or (c) of this section; or

(2) The person holds an agricultural lien that has become effective at the time of filing and the financing statement covers only collateral in which the person holds an agricultural lien.

(b) By authenticating or becoming bound as debtor by a security agreement, a debtor or new debtor authorizes the filing of an initial financing statement, and an amendment, covering:

(1) The collateral described in the security agreement; and

(2) Property that becomes collateral under section 4-9-315 (a) (2), whether or not the security agreement expressly covers proceeds.

(c) By acquiring collateral in which a security interest or agricultural lien continues under section 4-9-315 (a) (1), a debtor authorizes the filing of an initial financing statement, and an amendment, covering the collateral and property that becomes collateral under section 4-9-315 (a) (2).

(d) A person may file an amendment other than an amendment that adds collateral covered by a financing statement or an amendment that adds a debtor to a financing statement only if:

(1) The secured party of record authorizes the filing; or

(2) The amendment is a termination statement for a financing statement as to which the secured party of record has failed to file or send a termination statement as required by section 4-9-513 (a) or (c), the debtor authorizes the filing, and the termination statement indicates that the debtor authorized it to be filed.

(e) If there is more than one secured party of record for a financing statement, each secured party of record may authorize the filing of an amendment under subsection (d) of this section.

Source: L. 2001: Entire article R&RE, p. 1383, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado added the phrase "or pursuant to subsection (b) or (c) of this section" to subsection (a)(1).

OFFICIAL COMMENT

1. **Source.** New.

2. **Scope and Approach of This Section.** This section collects in one place most of the rules determining whether a record may be filed. Section 9-510 explains the extent to which a filed record is effective. Under these sections, the identity of the person who effects a filing is immaterial. The filing scheme contemplated by this Part does not contemplate that the identity of a "filer" will be a part of the searchable records. This is consistent with, and a necessary aspect of, eliminating signatures or other evidence of authorization from the system. (Note that the 1972 amendments to this Article eliminated the requirement that a financing statement contain the signature of the secured party.) As long as the appropriate person authorizes the filing, or, in the case of a termination statement, the debtor is entitled to the termination, it is insignificant whether the secured party or another person files any given record. The question of authorization is one for the court, not the filing office. However, a filing office may choose to employ authentication procedures in connection with electronic communications, e.g., to verify the identity of a filer who seeks to charge the filing fee.

3. **Unauthorized Filings.** Records filed in the filing office do not require signatures for their effectiveness. Subsection (a)(1) substitutes for the debtor's signature on a financing statement the requirement that the debtor authorize in an authenticated record the filing of an initial financing statement or an amendment that adds collateral. Also, under subsection (a)(1), if an amendment adds a debtor, the debtor who is added must authorize the amendment. A person who files an unauthorized record in violation of subsection (a)(1) is liable under Section 9-625 (b) and (e) for actual and statutory damages. Of course, a filed financing statement is ineffective to perfect a security interest if the filing is not authorized. See Section 9-510(a). Law other than this Article, including the law with respect to ratification of past acts, generally determines whether a person has the requisite authority to file a record under this section. See Sections 1-103, 9-502, Comment 3. This Article applies to other issues, such as the priority of a security interest perfected by the filing of a financing statement. [See Section 9-322, Comment 4.]
Note: The bracketed language takes effect July 1, 2013.

4. *Ipso Facto* **Authorization.** Under subsection (b), the authentication of a security agreement *ipso facto* constitutes the debtor's authorization of the filing of a financing statement covering the collateral described in the security agreement. The secured party need not obtain a separate authorization. Similarly, a new debtor's becoming bound by a security agreement *ipso facto* constitutes the new debtor's authorization of the filing of a financing statement covering the collateral described in the security agreement by which the new debtor has become bound. And, under subsection (c), the acquisition of collateral in which a security interest continues after disposition under Section 9-315(a)(1) *ipso facto* constitutes an authorization to file an initial financing statement against the person who acquired the collateral. The authorization to file an initial financing statement also constitutes an authorization to file a record covering actual proceeds of the original collateral, even if the security agreement is silent as to proceeds.

Example 1: Debtor authenticates a security agreement creating a security interest in Debtor's inventory in favor of Secured Party. Secured Party files a financing statement covering inventory and accounts. The financing statement is authorized insofar as it covers inventory and unauthorized insofar as it covers accounts. (Note, however, that the financing statement will be effective to perfect a security interest in accounts constituting proceeds of the inventory to the same extent as a financing statement covering only inventory.)

Example 2: Debtor authenticates a security agreement creating a security interest in Debtor's inventory in favor of Secured Party. Secured Party files a financing statement covering inventory. Debtor sells some inventory, deposits the buyer's payment into a deposit account, and withdraws the funds to purchase equipment. As long as the equipment can be traced to the inventory, the security interest continues in the equipment. See Section 9- 315(a)(2). However, because the equipment was acquired with cash proceeds, the financing statement becomes ineffective to perfect the security interest in the equipment on the 21st day after the security interest attaches to the equipment unless Secured Party continues perfection beyond the 20-day period by filing a financing statement against the equipment or amending the filed financing statement to cover equipment. See Section 9-315(d). Debtor's authentication of the security agreement authorizes the filing of an initial financing statement or amendment covering the equipment, which is "property that becomes collateral under Section 9-315(a)(2)." See Section 9-509(b)(2).

5. **Agricultural Liens.** Under subsection (a)(2), the holder of an agricultural lien may file

a financing statement covering collateral subject to the lien without obtaining the debtor's authorization. Because the lien arises as matter of law, the debtor's consent is not required. A person who files an unauthorized record in violation of this subsection is liable under Section 9-625(e) for a statutory penalty and damages.

6. **Amendments; Termination Statements Authorized by Debtor.** Most amendments may not be filed unless the secured party of record, as determined under Section 9-511, authorizes the filing. See subsection (d)(1). However, under subsection (d)(2), the authorization of the secured party of record is not required for the filing of a termination statement if the secured party of record failed to send or file a termination statement as required by Section 9-513, the debtor authorizes it to be filed, and the termination statement so indicates. [An authorization to file a record under subsection (d) is effective even if the authorization is not in an authenticated record. Compare subsection (a)(1). However, both the person filing the record and the person giving the authorization may wish to obtain and retain a record indicating that the filing was authorized.]

Note: The bracketed language takes effect July 1, 2013.

7. **Multiple Secured Parties of Record.** Subsection (e) deals with multiple secured parties of record. It permits each secured party of record to authorize the filing of amendments. However, Section 9-510(b) protects the rights and powers of one secured party of record from the effects of filings made by another secured party of record. See Section 9-510, Comment 3.

8. **Successor to Secured Party of Record.** A person may succeed to the powers of the secured party of record by operation of other law, e.g., the law of corporate mergers. In that case, the successor has the power to authorize filings within the meaning of this section.

4-9-510. Effectiveness of filed record. (a) A filed record is effective only to the extent that it was filed by a person that may file it under section 4-9-509.

(b) A record authorized by one secured party of record does not affect the financing statement with respect to another secured party of record.

(c) Subject to section 4-9-528 and subsection (d) of this section, a continuation statement that is not filed within the six-month period prescribed by section 4-9-515 (d) is ineffective.

(d) Any continuation statement filed on or after July 1, 1996, and before January 1, 1998, including one that was perfected by filing with both the offices of the secretary of state and a county clerk and recorder, continues the perfection in all of the collateral listed on the filing. With respect to continuation statements filed on or after July 1, 1996, and before January 1, 1998, the filing of a single continuation statement shall maintain the effectiveness of financing statements that name identical collateral but have been filed in multiple locations.

(e) No continuation statement filed on or after July 1, 1995, shall be ineffective solely because it failed to include a statement that the original financing statement is still effective.

Source: L. 2001: Entire article R&RE, p. 1383, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado added the phrase "Subject to section 4-9-528 and subsection (d) of this section," to subsection (c) and added subsections (d) and (e).

OFFICIAL COMMENT

1. **Source.** New.

2. **Ineffectiveness of Unauthorized or Overbroad Filings.** Subsection (a) provides that a filed financing statement is effective only to the extent it was filed by a person entitled to file it.

Example 1: Debtor authorizes the filing of a financing statement covering inventory. Under Section 9-509, the secured party may file a financing statement covering only inventory; it may not file a financing statement covering other collateral. The secured party files a financing statement covering inventory and equipment. This section provides that the financing statement is effective only to the extent the secured party may file it. Thus, the financing statement is effective to perfect a security interest in inventory but ineffective to perfect a security interest in equipment.

3. **Multiple Secured Parties of Record.** Section 9-509(e) permits any secured party of record to authorize the filing of most amendments. Subsection (b) of this section prevents a filing authorized by one secured party of record

from affecting the rights and powers of another secured party of record without the latter's consent.

Example 2: Debtor creates a security interest in favor of A and B. The filed financing statement names A and B as the secured parties. An amendment deleting some collateral covered by the financing statement is filed pursuant to B's authorization. Although B's security interest in the deleted collateral becomes unperfected, A's security interest remains perfected in all the collateral.

Example 3: Debtor creates a security interest in favor of A and B. The financing statement names A and B as the secured parties. A termination statement is filed pursuant to B's authorization. Although the effectiveness of the financing statement terminates with respect to B's security interest, A's rights are unaffected. That is, the financing statement continues to be effective to perfect A's security interest.

4. **Continuation Statements.** A continuation statement may be filed only within the six months immediately before lapse. See Section 9-515(d). The filing office is obligated to reject a continuation statement that is filed outside the six-month period. See Sections 9-520(a), 9-516(b)(7). Subsection (c) provides that if the filing office fails to reject a continuation statement that is not filed in a timely manner, the continuation statement is ineffective nevertheless.

4-9-511. Secured party of record. (a) A secured party of record with respect to a financing statement is a person whose name is provided as the name of the secured party or a representative of the secured party in an initial financing statement that has been filed. If an initial financing statement is filed under section 4-9-514 (a), the assignee named in the initial financing statement is the secured party of record with respect to the financing statement.

(b) If an amendment of a financing statement which provides the name of a person as a secured party or a representative of a secured party is filed, the person named in the amendment is a secured party of record. If an amendment is filed under section 4-9-514 (b), the assignee named in the amendment is a secured party of record.

(c) A person remains a secured party of record until the filing of an amendment of the financing statement which deletes the person.

Source: L. 2001: Entire article R&RE, p. 1384, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.
2. **Secured Party of Record.** This new section explains how the secured party of record is to be determined. If SP-1 is named as the secured party in an initial financing statement, it is the secured party of record. Similarly, if an initial financing statement reflects a total assignment from SP-0 to SP-1, then SP-1 is the secured party of record. See subsection (a). If, subsequently, an amendment is filed assigning SP-1's status to SP-2, then SP-2 becomes the secured party of record in place of SP-1. The same result obtains if a subsequent amendment deletes the reference to SP-1 and substitutes therefor a reference to SP-2. If, however, a subsequent amendment adds SP-2 as a secured party but does not purport to remove SP-1 as a secured party, then SP-2 and SP-1 each is a secured party of record. See subsection (b). An amendment purporting to remove the only secured party of record without providing a successor is ineffective. See Section 9-512(e). At any point in time, all effective records that comprise a financing statement must be examined to determine the person or persons that have the status of secured party of record.
3. **Successor to Secured Party of Record.** Application of other law may result in a person succeeding to the powers of a secured party of record. For example, if the secured party of record (A) merges into another corporation (B) and the other corporation (B) survives, other law may provide that B has all of A's powers. In that case, B is authorized to take all actions under this Part that A would have been authorized to take. Similarly, acts taken by a person who is authorized under generally applicable principles of agency to act on behalf of the secured party of record are effective under this Part.

4-9-512. Amendment of financing statement. (a) Subject to section 4-9-509, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or, subject to subsection (e) of this section, otherwise amend the information provided in, a financing statement by filing an amendment that:

(1) Identifies, by file number, the initial financing statement to which the amendment relates; and

(2) Provides the date that the initial financing statement was filed or recorded.

(b) Except as otherwise provided in section 4-9-515, the filing of an amendment does not extend the period of effectiveness of the financing statement.

(c) A financing statement that is amended by an amendment that adds collateral is effective as to the added collateral only from the date of the filing of the amendment.

(d) A financing statement that is amended by an amendment that adds a debtor is effective as to the added debtor only from the date of the filing of the amendment.

(e) An amendment is ineffective to the extent it:

(1) Purports to delete all debtors and fails to provide the name of a debtor to be covered by the financing statement; or

(2) Purports to delete all secured parties of record and fails to provide the name of a new secured party of record.

Source: L. 2001: Entire article R&RE, p. 1384, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-402 (4) as it existed prior to 2001.

(2) **Colorado legislative change:** Subsection (a)(2) of the uniform act states: "if the amendment relates to an initial financing statement filed [or recorded] in a filing office described in Section 9-501(a)(1), provides the date and time that the initial financing statement was filed or recorded and the information specified in Section 9-502 (b)."

OFFICIAL COMMENT

1. **Source.** Former 9-402(4).

2. **Changes to Financing Statements.** This section addresses changes to financing statements, including addition and deletion of collateral. Although termination statements, assignments, and continuation statements are types of amendment, this Article follows former Article 9 and contains separate sections containing additional provisions applicable to particular types of amendments. See Section 9-513 (termination statements); 9-514 (assignments); 9-515 (continuation statements). One should not infer from this separate treatment that this Article requires a separate amendment to accomplish each change. Rather, a single amendment would be legally sufficient to, e.g., add collateral and continue the effectiveness of the financing statement.

3. **Amendments.** An amendment under this Article may identify only the information contained in a financing statement that is to be changed; alternatively, it may take the form of an amended and restated financing statement. The latter would state, for example, that the financing statement "is amended and restated to read as follows: . . ." References in this Part to an "amended financing statement" are to a financing statement as amended by an amendment using either technique.

This section revises former Section 9-402(4) to permit secured parties of record to make changes in the public record without the need to obtain the debtor's signature. However, the filing of an amendment that adds collateral or adds a debtor must be authorized by the debtor or it will not be effective. See Sections 9-509(a), 9-510(a).

4. **Amendment Adding Debtor.** An amendment that adds a debtor is effective, provided that the added debtor authorizes the filing. See Section 9-509(a). However, filing an amendment adding a debtor to a previously filed financing statement affords no advantage over filing an initial financing statement against that debtor and may be disadvantageous. With respect to the added debtor, for purposes of determining the priority of the security interest, the time of filing is the time of the filing of the amendment, not the time of the filing of the initial financing statement. See subsection (d). However, the effectiveness of the financing statement lapses with respect to added debtor at the time it lapses with respect to the original debtor. See subsection (b).

[5. **Amendment Adding Debtor Name.** Many states have enacted statutes governing the "conversion" of one organization organized under the law of that state, e.g., a corporation, into another such organization, e.g., a limited liability company. This Article defers to those statutes to determine whether the resulting organization is the same legal person as the initial, converting organization (albeit with a different name) or whether the resulting organization is a different legal person. When the governing statute does not clearly resolve the question, a secured party whose debtor is the converting organization may wish to proceed as if the statute provides for both results. In these circumstances, an amendment adding to the initial financing statement

the name of the resulting organization may be preferable to an amendment substituting that name for the name of the debtor provided on the initial financing statement. In the event the governing statute is construed as providing that the resulting organization is the same legal person as the converting organization, but with a different name, the timely filing of such an amendment would satisfy the requirement of Section 9-507(c)(2). If, however, the governing statute is construed as providing that the resulting organization is a different legal person, the financing statement (which continues to provide the name of the original debtor) would be effective as to collateral acquired by the resulting organization ("new debtor") before, and within four months after, the conversion. See Section 9-508(b)(1). Inasmuch as it is the first financing statement filed against the resulting organization by the secured party, the record adding the name of the resulting organization as a debtor would constitute "an initial financing statement providing the name of the new debtor " under Section 9-508(b)(2). The secured party also may wish to file another financing statement naming the resulting organization as debtor. See Comment 4.]

Note: The bracketed language takes effect July 1, 2013.

5. **Deletion of All Debtors or Secured Parties of Record.** Subsection (e) assures that there will be a debtor and secured party of record for every financing statement.

Note: This paragraph 5. will be renumbered as 6. effective July 1, 2013.

Example: A filed financing statement names A and B as secured parties of record and covers inventory and equipment. An amendment deletes equipment and purports to delete A and B as secured parties of record without adding a substitute secured party. The amendment is ineffective to the extent it purports to delete the secured parties of record but effective with respect to the deletion of collateral. As a consequence, the financing statement, as amended, covers only inventory, but A and B remain as secured parties of record.

4-9-513. Termination statement. (a) A secured party shall cause the secured party of record for a financing statement to file a termination statement for the financing statement if the financing statement covers consumer goods and:

(1) There is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value; or

(2) The debtor did not authorize the filing of the initial financing statement.

(b) To comply with subsection (a) of this section, a secured party shall cause the secured party of record to file the termination statement:

(1) Within one month after there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value; or

(2) If earlier, within twenty days after the secured party receives an authenticated demand from a debtor.

(c) In cases not governed by subsection (a) of this section, within twenty days after a secured party receives an authenticated demand from a debtor, the secured party shall cause the secured party of record for a financing statement to send to the debtor a termination statement for the financing statement or file the termination statement in the filing office if:

(1) Except in the case of a financing statement covering accounts or chattel paper that has been sold or goods that are the subject of a consignment, there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value;

(2) The financing statement covers accounts or chattel paper that has been sold but as to which the account debtor or other person obligated has discharged its obligation;

(3) The financing statement covers goods that were the subject of a consignment to the debtor but are not in the debtor's possession; or

(4) The debtor did not authorize the filing of the initial financing statement.

(d) Except as otherwise provided in section 4-9-510, upon the filing of a termination statement with the filing office, the financing statement to which the termination statement relates ceases to be effective. Except as otherwise provided in section 4-9-510, for purposes of sections 4-9-519 (g), 4-9-522 (a), and 4-9-523 (c), the filing with the filing office of a termination statement relating to a financing statement that indicates that the debtor is a transmitting utility also causes the effectiveness of the financing statement to lapse.

Source: L. 2001: Entire article R&RE, p. 1385, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-404 as it existed prior to 2001.
(2) **Colorado legislative change:** Colorado added the last sentence of subsection (d).

OFFICIAL COMMENT

1. **Source.** Former Section 9-404.

2. **Duty to File or Send.** This section specifies when a secured party must cause the secured party of record to file or send to the debtor a termination statement for a financing statement. Because most financing statements expire in five years unless a continuation statement is filed (Section 9-515), no compulsion is placed on the secured party to file a termination statement unless demanded by the debtor, except in the case of consumer goods. Because many consumers will not realize the importance to them of clearing the public record, an affirmative duty is put on the secured party in that case. But many purchase-money security interests in consumer goods will not be filed, except for motor vehicles. See Section 9-309(1). Under Section 9-311(b), compliance with a certificate-of-title statute is "equivalent to the filing of a financing statement under this article." Thus, this section applies to a certificate of title unless the section is superseded by a certificate-of-title statute that contains a specific rule addressing a secured party's duty to cause a notation of a security interest to be removed from a certificate of title. In the context of a certificate of title, however, the secured party could comply with this section by causing the removal itself or providing the debtor with documentation sufficient to enable the debtor to effect the removal.

Subsections (a) and (b) apply to a financing statement covering consumer goods. Subsection (c) applies to other financing statements. Subsection (a) and (c) each makes explicit what was implicit under former Article 9: If the debtor did not authorize the filing of a financing statement in the first place, the secured party of record should file or send a termination statement. The liability imposed upon a secured party that fails to comply with subsection (a) or (c) is identical to that imposed for the filing of an unauthorized financing statement or amendment. See Section 9-625(e).

3. **"Bogus" Filings.** A secured party's duty to send a termination statement arises when the secured party "receives" an authenticated demand from the debtor. In the case of an unauthorized financing statement, the person named as debtor in the financing statement may have no relationship with the named secured party and no reason to know the secured party's address. Inasmuch as the address in the financing statement is "held out by [the person named as secured party in the financing statement] as the place for receipt of such communications [i.e., communications relating to security interests]," the putative secured party is deemed to have "received" a notification delivered to that address. See Section 1-201(26). If a termination statement is not forthcoming, the person named as debtor itself may authorize the filing of a termination statement, which will be effective if it indicates that the person authorized it to be filed. See Sections 9-509(d)(2), 9-510(c).
Note:"1-201(26)." in the fourth sentence will be replaced with "1-202(e)." effective July 1, 2013.

4. **Buyers of Receivables.** Applied literally, former Section 9-404(1) would have required many buyers of receivables to file a termination statement immediately upon filing a financing statement because "there is no outstanding secured obligation and no commitment to make advances, incur obligations, or otherwise give value." Subsections (c)(1) and (2) remedy this problem. While the security interest of a buyer of accounts or chattel paper (B-1) is perfected, the debtor is not deemed to retain an interest in the sold receivables and thus could transfer no interest in them to another buyer (B-2) or to a lien creditor (LC). However, for purposes of determining the rights of the debtor's creditors and certain purchasers of accounts or chattel paper from the debtor, while B-1's security interest is unperfected, the debtor-seller is deemed to have rights in the sold receivables, and a competing security interest or judicial lien may attach to those rights. See Sections 9-318, 9-109, Comment 5. Suppose that B-1's security interest in certain accounts and chattel paper is perfected by filing, but the effectiveness of the financing statement lapses. Both before and after lapse, B-1 collects some of the receivables. After lapse, LC acquires a lien on the accounts and chattel paper. B-1's unperfected security interest in the accounts and chattel paper is subordinate to LC's rights. See Section 9-317(a)(2). But collections on accounts and chattel paper are not "accounts" or "chattel paper." Even if B-1's security interest in the accounts and chattel paper is or becomes unperfected, neither the debtor nor LC acquires rights to the collections that B-1 collects (and owns) before LC acquires a lien.

5. **Effect of Filing.** Subsection (d) states the effect of filing a termination statement: the related financing statement ceases to be effective. If one of several secured parties of record files a termination statement, subsection (d) applies only with respect to the rights of the person who authorized the filing of the termination statement. See Section 9-510(b). The financing statement remains effective with respect to the rights of the others. However, even if a financing

statement is *terminated* (and thus no longer is effective) with respect to all secured parties of record, the financing statement, including the termination statement, will remain of record until at least one year after it *lapses* with respect to all secured parties of record. See Section 9-519(g).

ANNOTATION

Law reviews. For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

4-9-514. Assignment of powers of secured party of record. (a) Except as otherwise provided in subsection (c) of this section, an initial financing statement may reflect an assignment of all of the secured party's power to authorize an amendment to the financing statement by providing the name and mailing address of the assignee as the name and address of the secured party.

(b) Except as otherwise provided in subsection (c) of this section, a secured party of record may assign of record all or part of its power to authorize an amendment to a financing statement by filing in the filing office an amendment of the financing statement that:

(1) Identifies, by its file number, the initial financing statement to which it relates;

(1.5) Provides the date that the initial financing statement was filed or recorded;

(2) Provides the name of the assignor; and

(3) Provides the name and mailing address of the assignee.

(c) An assignment of record of a security interest in a fixture covered by a record of a mortgage which is effective as a financing statement filed as a fixture filing under section 4-9-502 (c) may be made only by an assignment of record of the mortgage in the manner provided by law of this state other than this title.

(d) An assignment that was filed in accordance with this section prior to August 5, 2009, and that is on file in the filing office as of August 5, 2009, whether or not it provides the date that the initial financing statement was filed or recorded, shall be deemed to have been filed pursuant to and in accordance with this section as amended and shall have the same effect as if filed pursuant to this section as amended.

Source: L. 2001: Entire article R&RE, p. 1386, § 1, effective July 1. **L. 2009:** IP(b) and (b)(2) amended and (b)(1.5) and (d) added, (SB 09-084), ch. 141, p. 602, §§ 1, 2, effective August 5.

Editor's note: (1) This section is similar to former § 4-9-405 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado added the phrase "and the name of one of the debtors" to subsection (b)(2).

OFFICIAL COMMENT

1. **Source.** Former Section 9-405.

2. **Assignments.** This section provides a permissive device whereby a secured party of record may effectuate an assignment of its power to affect a financing statement. It may also be useful for a secured party who has assigned all or part of its security interest or agricultural lien and wishes to have the fact noted of record, so that inquiries concerning the transaction would be addressed to the assignee. See Section 9-502, Comment 2. Upon the filing of an assignment, the assignee becomes the "secured party of record" and may authorize the filing of a continuation statement, termination statement, or other amendment. Note that under Section 9-310(c) no filing of an assignment is required as a condition of continuing the perfected status of the security interest against creditors and transferees of the original debtor. However, if an assignment is not filed, the assignor remains the secured party of record, with the power (even if not the right) to authorize the filing of effective amendments. See Sections 9-511(c), 9-509(d).

Where a record of a mortgage is effective as a financing statement filed as a fixture filing (Section 9-502(c)), then an assignment of record of the security interest may be made only in the manner in which an assignment of record of the mortgage may be made under local real-property law.

3. **Comparison to Prior Law.** Most of the changes reflected in this section are for clarification or to embrace medium-neutral drafting. As a general matter, this section preserves the opportunity given by former Section 9-405 to assign a security interest of record in one of two different ways. Under subsection (a), a secured party may assign all of its power to affect a financing statement by naming an assignee in the initial financing statement. The secured party of record may accomplish the same result under subsection (b) by making a subsequent filing. Subsection (b) also may be used for an assignment of only some of the secured party of record's power to affect a financing statement, e.g., the power to affect the financing statement as it relates to particular items of collateral or as it relates to an undivided interest in a security interest in all the collateral. An initial financing statement may not be used to change the secured party of record under these circumstances. However, an amendment adding the assignee as a secured party of record may be used.

4-9-515. Duration and effectiveness of financing statement - effect of lapsed financing statement. (a) Except as otherwise provided in subsections (b), (e), (f), and (g) of this section and section 4-9-528, a filed financing statement is effective for a period of five years after the date of filing.

(b) Except as otherwise provided in subsections (e), (f), and (g) of this section, an initial financing statement filed in connection with a manufactured-home transaction is effective for a period of thirty years after the date of filing if it indicates that it is filed in connection with a manufactured-home transaction.

(c) The effectiveness of a filed financing statement lapses on the expiration of the period of its effectiveness unless before the lapse a continuation statement is filed pursuant to subsection (d) of this section. Upon lapse, a financing statement ceases to be effective and any security interest or agricultural lien that was perfected by the financing statement becomes unperfected, unless the security interest is perfected otherwise. If the security interest or agricultural lien becomes unperfected upon lapse, it is deemed never to have been perfected as against a purchaser of the collateral for value.

(d) A continuation statement may be filed only within six months before the expiration of the five-year period specified in subsection (a) of this section, the thirty-year period specified in subsection (b) of this section, or the five-year period specified in section 4-9-528 (a) (1), whichever is applicable.

(e) Except as otherwise provided in section 4-9-510, upon timely filing of a continuation statement, the effectiveness of the initial financing statement continues for a period of five years commencing on the day on which the financing statement would have become ineffective in the absence of the filing. Upon the expiration of the five-year period, the financing statement lapses in the same manner as provided in subsection (c) of this section, unless, before the lapse, another continuation statement is filed pursuant to subsection (d) of this section. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the initial financing statement.

(f) If a debtor is a transmitting utility and a filed financing statement so indicates, the financing statement is effective until a termination statement is filed.

Editor's note: This version of subsection (f) is effective until July 1, 2013.

(f) If a debtor is a transmitting utility and a filed initial financing statement so indicates, the financing statement is effective until a termination statement is filed.

Editor's note: This version of subsection (f) is effective July 1, 2013.

(g) A record of a mortgage that is effective as a financing statement filed as a fixture filing under section 4-9-502 (c) remains effective as a financing statement filed as a fixture filing until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real property.

Source: L. 2001: Entire article R&RE, p. 1386, § 1, effective July 1. **L. 2012:** (f) amended, (HB 12-1262), ch. 170, p. 602, § 12, effective July 1, 2013.

Editor's note: (1) This section is similar to former § 4-9-403 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado added the reference to section 4-9-528 in subsection (a) and the phrase "or the five-year period specified in section 4-9-528 (a)(1)" in subsection (d).

OFFICIAL COMMENT

1. **Source.** Former Section 9-403(2), (3), (6).

2. **Period of Financing Statement's Effectiveness.** Subsection (a) states the general rule: a financing statement is effective for a five-year period unless its effectiveness is continued under this section or terminated under Section 9-513. Subsection (b) provides that if the financing statement relates to a public-finance transaction or a manufactured-home transaction and so indicates, the financing statement is effective for 30 years. These financings typically extend well beyond the standard, five-year period. Under subsection (f), a financing statement filed against a transmitting utility remains effective indefinitely, until a termination statement is filed. Likewise, under subsection (g), a mortgage effective as a fixture filing remains effective until its effectiveness terminates under real-property law.

3. **Lapse.** When the period of effectiveness under subsection (a) or (b) expires, the effectiveness of the financing statement lapses. The last sentence of subsection (c) addresses the effect of lapse. The deemed retroactive unperfection applies only with respect to purchasers for value; unlike former Section 9-403(2), it does not apply with respect to lien creditors.

Example 1: SP-1 and SP-2 both hold security interests in the same collateral. Both security interests are perfected by filing. SP-1 filed first and has priority under Section 9-322(a)(1). The effectiveness of SP-1's filing lapses. As long as SP-2's security interest remains perfected thereafter, SP-2 is entitled to priority over SP-1's security interest, which is deemed never to have been perfected as against a purchaser for value (SP-2). See Section 9-322(a)(2).

Example 2: SP holds a security interest perfected by filing. On July 1, LC acquires a judicial lien on the collateral. Two weeks later, the effectiveness of the financing statement lapses. Although the security interest becomes unperfected upon lapse, it was perfected when LC acquired its lien. Accordingly, notwithstanding the lapse, the perfected security interest has priority over the rights of LC, who is not a purchaser. See Section 9-317(a)(2).

4. **Effect of Debtor's Bankruptcy.** Under former Section 9-403(2), lapse was tolled if the debtor entered bankruptcy or another insolvency proceeding. Nevertheless, being unaware that insolvency proceedings had been commenced, filing offices routinely removed records from the files as if lapse had not been tolled. Subsection (c) deletes the former tolling provision and thereby imposes a new burden on the secured party: to be sure that a financing statement does not lapse during the debtor's bankruptcy. The secured party can prevent lapse by filing a continuation statement, even without first obtaining relief from the automatic stay. See Bankruptcy Code Section 362(b)(3). Of course, if the debtor enters bankruptcy before lapse, the provisions of this Article with respect to lapse would be of no effect to the extent that federal bankruptcy law dictates a contrary result (e.g., to the extent that the Bankruptcy Code determines rights as of the date of the filing of the bankruptcy petition).

5. **Continuation Statements.** Subsection (d) explains when a continuation statement may be filed. A continuation statement filed at a time other than that prescribed by subsection (d) is ineffective, see Section 9-510(c), and the filing office may not accept it. See Sections 9-520(a), 9-516(b). Subsection (e) specifies the effect of a continuation statement and provides for successive continuation statements.

ANNOTATION

Law reviews. For article, "Commercial Law", see 56 Den. L.J. 409 (1979). For article, "Colorado Secretary of State Uniform Commercial Code Procedures", see 11 Colo. Law. 1542 (1982). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

Annotator's note. Since § 4-9-515 is similar to § 4-9-403 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

For legislative intent, see In re Vodco Volume Dev. Co., 567 F.2d 967 (10th Cir. 1977), appeal dismissed sub nom. Appleman v. Furety, 439 U.S. 806, 99 S. Ct. 62, 58 L. Ed.2d 98 (1978) (decided prior to 1977 amendment).

This section may not be employed to destroy prior perfected security interests in favor of a subsequent holder of a security interest. Western Nat'l Bank v. ABC Drilling Co., 42 Colo. App. 407, 599 P.2d 942 (1979).

For effect of filing continuation statement after properly filed financing statement had lapsed, prior to 1977 amendment, see In re Vodco Volume Dev. Co., 567 F.2d 967 (10th Cir. 1977), appeal dismissed sub nom. Appleman v. Furety, 439 U.S. 806, 99 S. Ct. 62, 58 L. Ed.2d 98 (1978) (decided prior to 1977 amendment).

Failure to file a continuation statement

within 60 days of the termination of a debtor's bankruptcy proceeding does not cause creditor's security interest to lapse when creditor has filed a continuation statement during the bankruptcy proceedings. John Deere Co. v. Alamosa Nat. Bank, 786 P.2d 505 (Colo. App. 1989).

4-9-516. What constitutes filing - effectiveness of filing. (a) Except as otherwise provided in subsection (b) of this section, communication of a record to a filing office and tender of the filing fee or acceptance of the record by the filing office constitutes filing.

(b) Filing does not occur with respect to a record that a filing office refuses to accept because:

(1) The record is not communicated by a method or medium of communication authorized by the filing office;

(2) An amount equal to or greater than the applicable filing fee is not tendered;

(3) The filing office is unable to index the record because:

(A) In the case of an initial financing statement, the record does not provide a name for the debtor;

(B) In the case of an amendment or correction statement, the record:

Editor's note: This version of the introductory portion to subparagraph (B) is effective until July 1, 2013.

(B) In the case of an amendment or information statement, the record:

Editor's note: This version of the introductory portion to subparagraph (B) is effective July 1, 2013.

(i) Does not identify the initial financing statement as required by section 4-9-512 or 4-9-518, as applicable; or

(ii) Identifies an initial financing statement whose effectiveness has lapsed under section 4-9-515;

(C) In the case of an initial financing statement that provides the name of a debtor identified as an individual or an amendment that provides a name of a debtor identified as an individual which was not previously provided in the financing statement to which the record relates, the record does not identify the debtor's last name; or

Editor's note: This version of subparagraph (C) is effective until July 1, 2013.

(C) In the case of an initial financing statement that provides the name of a debtor identified as an individual or an amendment that provides a name of a debtor identified as an individual that was not previously provided in the financing statement to which the record relates, the record does not identify the debtor's surname; or

Editor's note: This version of subparagraph (C) is effective July 1, 2013.

(D) In the case of a record filed or recorded in the filing office described in section 4-9-501 (a) (1), the record does not provide a sufficient description of the real property to which it relates;

(4) In the case of an initial financing statement or an amendment that adds a secured party of record, the record does not provide a name and mailing address for the secured party of record;

(5) In the case of an initial financing statement or an amendment that provides a name of a debtor which was not previously provided in the financing statement to which the amendment relates, the record does not:

Editor's note: This version of the introductory portion to paragraph (5) is effective until July 1, 2013.

(5) In the case of an initial financing statement or an amendment that provides a name of a debtor that was not previously provided in the financing statement to which the amendment relates, the record does not:

Editor's note: This version of the introductory portion to paragraph (5) is effective July 1, 2013.

(A) Provide a mailing address for the debtor;

Editor's note: This version of subparagraph (A) is effective until July 1, 2013.

(A) Provide a mailing address for the debtor; or

Editor's note: This version of subparagraph (A) is effective July 1, 2013.

(B) Indicate whether the debtor is an individual or an organization; or

Editor's note: This version of subparagraph (B) is effective until July 1, 2013.

(B) Indicate whether the debtor is an individual or an organization.

Editor's note: This version of subparagraph (B) is effective July 1, 2013.

(C) If the financing statement indicates that the debtor is an organization, provide:
(i) A type of organization for the debtor;
(ii) A jurisdiction of organization for the debtor; or
(iii) An organizational identification number for the debtor or indicate that the debtor has none;

Editor's note: This version of subparagraph (C) is effective until July 1, 2013.

(C) Repealed.

Editor's note: This version of subparagraph (C) is effective July 1, 2013.

(6) In the case of an assignment reflected in an initial financing statement under section 4-9-514 (a) or an amendment filed under section 4-9-514 (b), the record does not provide a name and mailing address for the assignee; or

(7) In the case of a continuation statement, the record is not filed within the six-month period prescribed by section 4-9-515 (d).

(c) For purposes of subsection (b) of this section:

(1) A record does not provide information if the filing office is unable to read or decipher the information; and

(2) A record that does not indicate that it is an amendment or identify an initial financing statement to which it relates, as required by section 4-9-512, 4-9-514, or 4-9-518, is an initial financing statement.

(d) A record that is communicated to the filing office with tender of the filing fee, but which the filing office refuses to accept for a reason other than one set forth in subsection (b) of this section, is effective as a filed record except as against a purchaser of the collateral which gives value in reasonable reliance upon the absence of the record from the files.

Source: L. 2001: Entire article R&RE, p. 1387, § 1, effective July 1. **L. 2012:** IP(b)(3)(B), (b)(3)(C), IP(b)(5), (b)(5)(A), and (b)(5)(B) amended and (b)(5)(C) repealed, (HB 12-1262), ch. 170, p. 602, § 13, effective July 1, 2013.

OFFICIAL COMMENT

1. **Source.** Subsection (a): former Section 9-403(1); the remainder is new.

2. **What Constitutes Filing.** Subsection (a) deals generically with what constitutes filing of a record, including an initial financing statement and amendments of all kinds (e.g., assignments, termination statements, and continuation statements). It follows former Section 9-403(1), under which either acceptance of a record by the filing office or presentation of the record and tender of the filing fee constitutes filing.

3. **Effectiveness of Rejected Record.** Subsection (b) provides an exclusive list of grounds upon which the filing office may reject a record. See Section 9-520(a). Although some of these grounds would also be grounds for rendering a filed record ineffective (e.g., an initial financing statement does not provide a name for the debtor), many others would not be (e.g., an initial financing statement does not provide a mailing address for the debtor or secured party of record). Neither this section nor Section 9-520 requires or authorizes the filing office to determine, or even consider, the accuracy of information provided in a record. [For example, the State A filing office may not reject under subsection (b)(5)(C) an initial financing statement indicating that the debtor is a State A

corporation and providing a three-digit organizational identification number, even if all State A organizational identification numbers contain at least five digits and two letters. Some organizations that are not registered organizations (such as foreign corporations) have a readily determinable jurisdiction of organization. When that is not the case, for purposes of this section, the jurisdiction of organization for a debtor that is an organization but not a registered organization is any jurisdiction that bears a reasonable relation to the debtor. For example, the jurisdiction of organization may be the jurisdiction in which the debtor is located under Section 9-307(b) (i.e., its place of business or chief executive office) or the jurisdiction stated in any organizational document or agreement for the debtor as the jurisdiction under whose law the organization is formed or as the jurisdiction whose law is the governing law. Thus, for purposes of this section, more than one jurisdiction may qualify as the debtor's jurisdiction of organization. See Comment 9.]

Note: The bracketed language is deleted, effective July 1, 2013.

A financing statement or other record that is communicated to the filing office but which the filing office refuses to accept provides no public notice, regardless of the reason for the rejection. However, this section distinguishes between records that the filing office rightfully rejects and those that it wrongfully rejects. A filer is able to prevent a rightful rejection by complying with the requirements of subsection (b). No purpose is served by giving effect to records that justifiably never find their way into the system, and subsection (b) so provides.

Subsection (d) deals with the filing office's unjustified refusal to accept a record. Here, the filer is in no position to prevent the rejection and as a general matter should not be prejudiced by it. Although wrongfully rejected records generally are effective, subsection (d) contains a special rule to protect a third-party purchaser of the collateral (e.g., a buyer or competing secured party) who gives value in reliance upon the apparent absence of the record from the files. As against a person who searches the public record and reasonably relies on what the public record shows, subsection (d) imposes upon the filer the risk that a record failed to make its way into the filing system because of the filing office's wrongful rejection of it. (Compare Section 9-517, under which a mis-indexed financing statement is fully effective.) This risk is likely to be small, particularly when a record is presented electronically, and the filer can guard against this risk by conducting a post-filing search of the records. Moreover, Section 9-520(b) requires the filing office to give prompt notice of its refusal to accept a record for filing.

4. **Method or Medium of Communication.** Rejection pursuant to subsection (b)(1) for failure to communicate a record properly should be understood to mean noncompliance with procedures relating to security, authentication, or other communication-related requirements that the filing office may impose. Subsection (b)(1) does not authorize a filing office to impose additional substantive requirements. See Section 9-520, Comment 2.

5. **Address for Secured Party of Record.** Under subsection (b)(4) and Section 9-520(a), the lack of a mailing address for the secured party of record requires the filing office to reject an initial financing statement. The failure to include an address for the secured party of record no longer renders a financing statement ineffective. See Section 9-502(a). The function of the address is not to identify the secured party of record but rather to provide an address to which others can send required notifications, e.g., of a purchase-money security interest in inventory or of the disposition of collateral. Inasmuch as the address shown on a filed financing statement is an "address that is reasonable under the circumstances," a person required to send a notification to the secured party may satisfy the requirement by sending a notification to that address, even if the address is or becomes incorrect. See Section 9-102 (definition of "send"). Similarly, because the address is "held out by [the secured party] as the place for receipt of such communications [i.e., communications relating to security interests]," the secured party is deemed to have received a notification delivered to that address. See Section 1-201(26).

Note: "1-201(26)." will be replaced with "1-202(e)." effective July 1, 2013.

6. **Uncertainty Concerning Individual Debtor's Last Name.** Subsection (b)(3)(C) requires the filing office to reject an initial financing statement or amendment adding an individual debtor if the office cannot index the record because it does not identify the debtor's last name (e.g., it is unclear whether the debtor's name is Elton John or John Elton).

Note: This version of paragraph 6. is effective until July 1, 2013.

6. **Uncertainty Concerning Individual Debtor's Surname.** Subsection (b)(3)(C) requires the filing office to reject an initial financing statement or amendment adding an individual debtor if the office cannot index the record because it does not identify the debtor's surname (e.g., it is unclear whether the debtor's surname is Elton or John).

Note: This version of paragraph 6. is effective July 1, 2013.

7. **Inability of Filing Office to Read or Decipher Information.** Under subsection (c)(1), if the filing office cannot read or decipher information, the information is not provided by a record for purposes of subsection (b).

8. **Classification of Records.** For purposes of subsection (b), a record that does not indicate it is an amendment or identify an initial financing statement to which it relates is deemed to be an initial financing statement. See subsection (c)(2).

9. **Effectiveness of Rejectable But Unrejected Record.** Section 9-520(a) requires the filing office to refuse to accept an initial financing statement for a reason set forth in subsection (b). However, if the filing office accepts such a financing statement nevertheless, the financing statement generally is effective if it complies with the requirements of Section 9-502(a) and (b). See Section 9-520(c). Similarly, an otherwise effective financing statement generally remains so even though the information in the financing statement becomes incorrect. See Section 9-507(b). (Note that if the information required by subsection (b)(5) is incorrect when the financing statement is filed, Section 9-338 applies.)

4-9-517. Effect of indexing errors. The failure of the filing office to index a record correctly does not affect the effectiveness of the filed record.

Source: L. 2001: Entire article R&RE, p. 1389, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.
2. **Effectiveness of Mis-Indexed Records.** This section provides that the filing office's error in mis-indexing a record does not render ineffective an otherwise effective record. As did former Section 9-401, this section imposes the risk of filing-office error on those who search the files rather than on those who file.

4-9-518. Claim concerning inaccurate or wrongfully filed record. (a) (1) Any person named as a debtor may file in the filing office a correction statement with respect to a record indexed there under the debtor's name if the person believes that the record is inaccurate or was wrongfully filed.

(2) Any person named as a secured party may file in the filing office a correction statement with respect to a record filed there in which the person is identified as a secured party, consignor, lessor, or the like if the person believes the record is inaccurate or was wrongfully filed.

(3) Any person who incorrectly files an amendment affecting a record may file a correction statement with respect to the record.

(b) A correction statement must:

(1) Identify the record to which it relates by:

(A) The file number assigned to the initial financing statement to which the record relates; and

(B) If the correction statement relates to a record filed or recorded in a filing office described in section 4-9-501 (a) (1), the date that the initial financing statement was filed or recorded;

(2) Indicate that it is a correction statement; and

(3) Provide the basis for the person's belief that the record is inaccurate and indicate the manner in which the person believes the record should be amended to cure any inaccuracy or provide the basis for the person's belief that the record was wrongfully filed.

(c) The filing of a correction statement does not affect the effectiveness of an initial financing statement or other filed record.

(d) The filing of a correction statement is not effective as an amendment to a filed financing statement and is not sufficient to effect a change in the manner in which the filing office has indexed a financing statement or information contained in a financing statement.

Editor's note: This version of this section is effective until July 1, 2013.

4-9-518. Claim concerning inaccurate or wrongfully filed record. (a) (1) Any person named as a debtor may file in the filing office an information statement with respect to a record indexed there under the debtor's name if the person believes that the record is inaccurate or was wrongfully filed.

(2) Any person named as a secured party may file in the filing office an information statement with respect to a record filed there in which the person is identified as a secured party, consignor, lessor, or the like if the person believes the record is inaccurate or was wrongfully filed.

(3) Any person who incorrectly files an amendment affecting a record may file an information statement with respect to the record.

(b) An information statement under subsection (a) of this section must:

(1) Identify the record to which it relates by:

(A) The file number assigned to the initial financing statement to which the record relates; and

(B) If the information statement relates to a record filed or recorded in a filing office described in section 4-9-501 (a) (1), the date that the initial financing statement was filed or recorded;

(2) Indicate that it is an information statement; and

(3) Provide the basis for the person's belief that the record is inaccurate and indicate the manner in which the person believes the record should be amended to cure any inaccuracy or provide the basis for the person's belief that the record was wrongfully filed.

(c) A person may file in the filing office an information statement with respect to a record filed there if the person is a secured party of record with respect to the financing statement to which the record relates and believes that the person that filed the record was not entitled to do so under section 4-9-509 (d).

(d) An information statement under subsection (c) of this section must:

(1) Identify the record to which it relates by:

(A) The file number assigned to the initial financing statement to which the record relates; and

(B) If the information statement relates to a record filed or recorded in a filing office described in section 4-9-501 (a) (1), the date that the initial financing statement was filed or recorded;

(2) Indicate that it is an information statement; and

(3) Provide the basis for the person's belief that the person that filed the record was not entitled to do so under section 4-9-509 (d).

(e) The filing of an information statement does not affect the effectiveness of an initial financing statement or other filed record.

(f) The filing of an information statement is not effective as an amendment to a filed financing statement and is not sufficient to effect a change in the manner in which the filing office has indexed a financing statement or information contained in a financing statement.

Editor's note: This version of this section is effective July 1, 2013.

Source: L. 2001: Entire article R&RE, p. 1389, § 1, effective July 1. **L. 2008:** (a) amended and (d) added, p. 266, § 1, effective August 5. **L. 2010:** (a)(2) amended, (HB 10-1422), ch. 419, p. 2063, § 6, effective August 11. **L. 2012:** Entire section amended, (HB 12-1262), ch. 170, p. 603, § 14, effective July 1, 2013.

OFFICIAL COMMENT

1. **Source.** New.

2. **Correction Statements.** Former Article 9 did not afford a nonjudicial means for a debtor to correct a financing statement or other record that was inaccurate or wrongfully filed. Subsection (a) affords the debtor the right to file a correction statement. Among other requirements, the correction statement must provide the basis for the debtor's belief that the public record should be corrected. See subsection (b). These provisions, which resemble the analogous remedy in the Fair Credit Reporting Act, 15 U.S.C. § 1681i, afford an aggrieved person the opportunity to state its position on the public record. They do not permit an aggrieved person to change the legal effect of the public record. Thus, although a filed correction statement becomes part of the "financing statement," as defined in Section 9-102, the filing does not affect the effectiveness of the initial financing statement or any other filed record. See subsection (c).

This section does not displace other provisions of this Article that impose liability for

making unauthorized filings or failing to file or send a termination statement (see Section 9-625(e)), nor does it displace any available judicial remedies.

Note: This version of this paragraph 2. is effective until July 1, 2013.

2. **Information Statements.** Former Article 9 did not afford a nonjudicial means for a debtor to indicate that a financing statement or other record was inaccurate or wrongfully filed. Subsection (a) affords the debtor the right to file information statement. Among other requirements, the information statement must provide the basis for the debtor's belief that the public record should be corrected. See subsection (b). These provisions, which resemble the analogous remedy in the Fair Credit Reporting Act, 15 U.S.C. 1681i, afford an aggrieved person the opportunity to state its position on the public record. They do not permit an aggrieved person to change the legal effect of the public record. Thus, although a filed information statement becomes part of the "financing statement," as defined in Section 9-102, the filing does not affect the effectiveness of the initial financing statement or any other filed record. See subsection (e).

Note: This version of this paragraph 2. takes effect July 1, 2013.

[Sometimes a person files a termination statement or other record relating to a filed financing statement without being entitled to do so. A secured party of record with respect to the financing statement who believes that such a record has been filed may, but need not, file an information statement indicating that the person that filed the record was not entitled to do so. See subsection (c). An information statement has no legal effect. Its sole purpose is to provide some limited public notice that the efficacy of a filed record is disputed. If the person that filed the record was not entitled to do so, the filed record is ineffective, regardless of whether the secured party of record files an information statement. Likewise, if the person that filed the record was entitled to do so, the filed record is effective, even if the secured party of record files an information statement. See Section 9-510(a), 9-518(e). Because an information statement filed under subsection (c) has no legal effect, a secured party of record — even one who is aware of the unauthorized filing of a record — has no duty to file one. Just as searchers bear the burden of determining whether the filing of initial financing statement was authorized, searchers bear the burden of determining whether the filing of every subsequent record was authorized.]

[Inasmuch as the filing of an information statement has no legal effect, this section does not provide a mechanism by which a secured party can correct an error that it discovers in its own financing statement.]

Note: The bracketed language takes effect July 1, 2013.

This section does not displace other provisions of this Article that impose liability for making unauthorized filings or failing to file or send a termination statement (see Section 9-625(e)), nor does it displace any available judicial remedies.

3. **Resort to Other Law.** This Article cannot provide a satisfactory or complete solution to problems caused by misuse of the public records. The problem of "bogus" filings is not limited to the UCC filing system but extends to the real-property records, as well. A summary judicial procedure for correcting the public record and criminal penalties for those who misuse the filing and recording systems are likely to be more effective and put less strain on the filing system than provisions authorizing or requiring action by filing and recording offices.

4-9-519. Numbering, maintaining, and indexing records - communicating information provided in records. (a) For each record filed in a filing office, the filing office shall:

(1) Assign a unique number to the filed record;

(2) Create a record that bears the number assigned to the filed record and the date and time of filing;

(3) Maintain the filed record for public inspection; and

(4) Index the filed record in accordance with subsections (c), (d), and (e) of this section.

(b) Repealed.

(c) Except as otherwise provided in subsections (d) and (e) of this section, the filing office shall:

(1) Index an initial financing statement according to the name of the debtor and index all filed records relating to the initial financing statement in a manner that associates with one another an initial financing statement and all filed records relating to the initial financing statement; and

(2) Index a record that provides a name of a debtor which was not previously provided in the financing statement to which the record relates also according to the name that was not previously provided.

(d) If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, it must be filed for record and the filing office shall index it:

(1) Under the names of the debtor and of each owner of record shown on the financing statement as if they were the mortgagors under a mortgage of the real property described; and

(2) To the extent that the law of this state provides for indexing of records of mortgages under the name of the mortgagee, under the name of the secured party as if the secured party were the mortgagee thereunder, or, if indexing is by description, as if the financing statement were a record of a mortgage of the real property described.

(e) If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, the filing office shall index an assignment filed under section 4-9-514 (a) or an amendment filed under section 4-9-514 (b):

(1) Under the name of the assignor as grantor; and

(2) To the extent that the law of this state provides for indexing a record of the assignment of a mortgage under the name of the assignee, under the name of the assignee.

(f) The filing office shall maintain a capability:

(1) To retrieve a record by the name of the debtor and:

(A) If the filing office is described in section 4-9-501 (a) (1), by the file number assigned to the initial financing statement to which the record relates and the date that the record was filed or recorded; or

(B) If the filing office is described in section 4-9-501 (a) (2), by the file number assigned to the initial financing statement to which the record relates; and

(2) To associate and retrieve with one another an initial financing statement and each filed record relating to the initial financing statement.

(g) The filing office may not remove a debtor's name from the index until one year after the effectiveness of a financing statement naming the debtor lapses under section 4-9-515 with respect to all secured parties of record.

(h) The filing office shall perform the acts required by subsections (a) to (e) of this section at the time and in the manner prescribed by filing-office rule, but not later than five business days after the filing office receives the record in question.

Source: L. 2001: Entire article R&RE, p. 1389, § 1, effective July 1. **L. 2009:** (b) repealed, (SB 09-084), ch. 141, p. 603, § 3, effective August 5.

Editor's note: (1) This section is similar to former § 4-9-403 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado did not adopt subsection (i).

OFFICIAL COMMENT

1. **Source.** Former Sections 9-403(4), (7), 9-405(2).

2. **Filing Office's Duties.** Subsections (a) through (e) set forth the duties of the filing office with respect to filed records. Subsection (h), which is new, imposes a minimum standard of performance for those duties. Prompt indexing is crucial to the effectiveness of any filing system. An accepted but un-indexed record affords no public notice. Subsection (f) requires the filing office to maintain appropriate storage and retrieval facilities, and subsection (g) contains minimum requirements for the retention of records.

3. **File Number.** Subsection (a)(1) requires the filing office to assign a unique number to each filed record. That number is the "file number" only if the record is an initial financing statement. See Section 9-102.

4. **Time of Filing.** Subsection (a)(2) and Section 9-523 refer to the "date and time" of filing. The statutory text does not contain any instructions to a filing office as to how the time of filing is to be determined. The method of determining or assigning a time of filing is an appropriate matter for filing-office rules to address.

5. **Related Records.** Subsections (c) and (f) are designed to ensure that an initial financing statement and all filed records relating to it are associated with one another, indexed under the name of the debtor, and retrieved together. To comply with subsection (f), a filing office (other than a real-property recording office in a State that enacts subsection (f), Alternative B) must be capable of retrieving records in each of two ways: by the name of the debtor and by the file number of the initial financing statement to which the record relates.

6. **Prohibition on Deleting Names from Index.** This Article contemplates that the filing office will not delete the name of a debtor from the index until at least one year passes after the effectiveness of the financing statement lapses as to all secured parties of record. See subsection (g). This rule applies even if the filing office accepts an amendment purporting to delete or modify the name of a debtor or terminate the effectiveness of the financing statement. If an amendment provides a modified name for a debtor, the amended name should be added to the index, see subsection (c)(2), but the pre-amendment name should remain in the index.

Compared to former Article 9, the rule in subsection (g) increases the amount of information available to those who search the public records. The rule also contemplates that searchers not the filing office will determine the significance and effectiveness of filed records.

4-9-520. Acceptance and refusal to accept record. (a) A filing office shall refuse to accept a record for filing for a reason set forth in section 4-9-516 (b) and may refuse to accept a record for filing only for a reason set forth in section 4-9-516 (b).

(b) If a filing office refuses to accept a record for filing, it shall communicate to the person that presented the record the fact of and reason for the refusal and the date and time the record would have been filed had the filing office accepted it. The communication must be made at the time and in the manner prescribed by filing-office rule but in no event more than five business days after the filing office receives the record.

(c) A filed financing statement satisfying section 4-9-502 (a) and (b) is effective, even if the filing office is required to refuse to accept it for filing under subsection (a) of this section. However, section 4-9-338 applies to a filed financing statement providing information described in section 4-9-516 (b) (5) which is incorrect at the time the financing statement is filed.

(d) If a record communicated to a filing office provides information that relates to more than one debtor, this part 5 applies as to each debtor separately.

Source: L. 2001: Entire article R&RE, p. 1391, § 1, effective July 1.

Editor's note - Colorado legislative change: In subsection (b), Colorado did not adopt the phrase "in the case of a filing office described in section 4-9-501(a)(2)," after the word "but" and changed "two" to "five".

OFFICIAL COMMENT

1. **Source.** New.

2. **Refusal to Accept Record for Filing.** In some States, filing offices considered themselves obligated by former Article 9 to review the form and content of a financing statement and to refuse to accept those that they determine are legally insufficient. Some filing offices imposed requirements for or conditions to filing that do not appear in the statute. Under this section, the filing office is not expected to make legal judgments and is not permitted to impose additional conditions or requirements.

Subsection (a) both prescribes and limits the bases upon which the filing office must and may reject records by reference to the reasons set forth in Section 9-516(b). For the most part, the bases for rejection are limited to those that prevent the filing office from dealing with a record that it receives because some of the requisite information (e.g., the debtor's name) is missing or cannot be deciphered, because the record is not communicated by a method (e.g., it is MIME- rather than UU-encoded) or medium (e.g., it is written rather than electronic) that the filing office accepts, or because the filer fails to tender an amount equal to or greater than the filing fee.

3. **Consequences of Accepting Rejectable Record.** Section 9-516(b) includes among the reasons for rejecting an initial financing statement the failure to give certain information that is not required as a condition of effectiveness. In conjunction with Section 9-516(b)(5), this section requires the filing office to refuse to accept a financing statement that is legally sufficient to perfect a security interest under Section 9-502 but does not contain a mailing address for the debtor, does not disclose whether the debtor is an individual or an organization (e.g., a partnership or corporation) or, if the debtor is an organization, does not give certain specified information concerning the organization. The information required by Section 9-516(b)(5) assists searchers in weeding out "false positives," i.e., records that a search reveals but which do not pertain to the debtor in question. It assists filers by helping to ensure that the debtor's name is correct and that the financing statement is filed in the proper jurisdiction.

Note: This version of paragraph 3. is effective until July 1, 2013.

3. **Consequences of Accepting Rejectable Record.** Section 9-516(b) includes among the reasons for rejecting an initial financing statement the failure to give certain information that is not required as a condition of effectiveness. In conjunction with Section 9-516(b)(5), this section requires the filing office to refuse to accept a financing statement that is legally sufficient to perfect a security interest under Section 9-502 but does not contain a mailing address for the debtor, or disclose whether the debtor is an individual or an organization. The information required by Section 9-516(b)(5) assists searchers in weeding out "false positives," i.e., records that a search reveals but which do not pertain to the debtor in question. It assists filers by helping to ensure that the debtor's name is correct and that the financing statement is filed in the proper jurisdiction.

Note: This version of paragraph 3. is effective July 1, 2013.

If the filing office accepts a financing statement that does not give this information at all, the filing is fully effective. Section 9-520(c). The financing statement also generally is effective if the information is given but is incorrect; however, Section 9-338 affords protection to buyers and holders of perfected security interests who give value in reasonable reliance upon the incorrect information.

4. **Filing Office's Duties with Respect to Rejected Record.** Subsection (b) requires the filing office to communicate the fact of rejection and the reason therefor within a fixed period of time. Inasmuch as a rightfully rejected record is ineffective and a wrongfully rejected record is not fully effective, prompt communication concerning any rejection is important.

5. **Partial Effectiveness of Record.** Under subsection (d), the provisions of this Part apply to each debtor separately. Thus, a filing office may reject an initial financing statement or other record as to one named debtor but accept it as to the other.

Example: An initial financing statement is communicated to the filing office. The financing statement names two debtors, John Smith and Jane Smith. It contains all of the information described in Section 9-516(b)(5) with respect to John but lacks some of the information with respect to Jane. The filing office must accept the financing statement with respect to John, reject it with respect to Jane, and notify the filer of the rejection.

4-9-521. Uniform form of written financing statement and amendment. (a) A filing office that accepts written records may not refuse to accept a written initial financing statement in the form and format adopted from time to time by the secretary of state, except for a reason set forth in section 4-9-516 (b).

(b) A filing office that accepts written records may not refuse to accept a written record in the form and format adopted from time to time by the secretary of state, except for a reason set forth in section 4-9-516 (b).

Source: L. 2001: Entire article R&RE, p. 1392, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado substituted the phrase "form and format adopted from time to time by the secretary of state," for the phrase "following form and format" in subsections (a) and (b).

OFFICIAL COMMENT

1. **Source.** New.

2. **"Safe Harbor" Written Forms.** Although Section 9-520 limits the bases upon which the filing office can refuse to accept records, this section provides sample written forms that must be accepted in every filing office in the country, as long as the filing office's rules permit it to accept written communications. By completing one of the forms in this section, a secured party can be certain that the filing office is obligated to accept it.

The forms in this section are based upon national financing statement forms that were in use under former Article 9. Those forms were developed over an extended period and reflect the comments and suggestions of filing officers, secured parties and their counsel, and service companies. The formatting of those forms and of the ones in this section has been designed to reduce error by both filers and filing offices.

A filing office that accepts written communications may not reject, on grounds of form or format, a filing using these forms. Although filers are not required to use the forms, they are encouraged and can be expected to do so, inasmuch as the forms are well designed and avoid the risk of rejection on the basis of form or format. As their use expands, the forms will rapidly become familiar to both filers and filing-office personnel. Filing offices may and should encourage the use of these forms by declaring them to be the "standard" (but not exclusive)

forms for each jurisdiction, albeit without in any way suggesting that alternative forms are unacceptable.

The multi-purpose form in subsection (b) covers changes with respect to the debtor, the secured party, the collateral, and the status of the financing statement (termination and continuation). A single form may be used for several different types of amendments at once (e.g., both to change a debtor's name and continue the effectiveness of the financing statement).

4-9-522. Maintenance and destruction of records. (a) The filing office shall maintain a record of the information provided in a filed financing statement for at least one year after the effectiveness of the financing statement has lapsed under section 4-9-515 with respect to all secured parties of record. The record must be retrievable by using the name of the debtor and the file number assigned to the initial financing statement to which the record relates and the date that the record was filed or recorded.

(b) Except to the extent that a statute governing disposition of public records provides otherwise, the filing office immediately may destroy any written record evidencing a financing statement. However, if the filing office destroys a written record, it shall maintain another record of the financing statement which complies with subsection (a) of this section.

Source: L. 2001: Entire article R&RE, p. 1392, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-403 (3) as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado did not adopt the phrase "by using" after the phrase "debtor and" and added the phrase "and the date that the record was filed or recorded" in subsection (a).

OFFICIAL COMMENT

1. **Source.** Former Section 9-403(3), revised substantially.

2. **Maintenance of Records.** Section 9-523 requires the filing office to provide information concerning certain lapsed financing statements. Accordingly, subsection (a) requires the filing office to maintain a record of the information in a financing statement for at least one year after lapse. During that time, the filing office may not delete any information with respect to a filed financing statement; it may only add information. This approach relieves the filing office from any duty to determine whether to substitute or delete information upon receipt of an amendment. It also assures searchers that they will receive all information with respect to financing statements filed against a debtor and thereby be able themselves to determine the state of the public record.

The filing office may maintain this information in any medium. Subsection (b) permits the filing office immediately to destroy written records evidencing a financing statement, provided that the filing office maintains another record of the information contained in the financing statement as required by subsection (a).

4-9-523. Information from filing office - sale or license of records. (a) If a person that files a written record requests an acknowledgment of the filing, the filing office shall send to the person an image of the record showing the number assigned to the record pursuant to section 4-9-519 (a) (1), the name of the debtor and the date and time of the filing of the record. However, if the person furnishes a copy of the record to the filing office, the filing office may instead:

(1) Note upon the copy the number assigned to the record pursuant to section 4-9-519 (a) (1) and the date and time of the filing of the record; and

(2) Send the copy to the person.

(b) If a person files a record other than a written record, the filing office shall communicate to the person an acknowledgment that provides:

(1) The information in the record;

(2) The number assigned to the record pursuant to section 4-9-519 (a) (1); and

(3) The date and time of the filing of the record.

(c) The filing office shall communicate or otherwise make available in a record the following information to any person that requests it:

(1) Whether there is on file on a date and time specified by the filing office, but not a

date earlier than three business days before the filing office receives the request, any financing statement that:

(A) Designates a particular debtor;

(B) Has not lapsed under section 4-9-515 with respect to all secured parties of record; and

(C) If the request so states, has lapsed under section 4-9-515 and a record of which is maintained by the filing office under section 4-9-522 (a);

(2) The date and time of filing of each financing statement; and

(3) The information provided in each financing statement.

(d) In complying with its duty under subsection (c) of this section, the filing office may communicate information in any medium. However, if requested, the filing office shall communicate information by issuing a record that can be admitted into evidence in the courts of this state without extrinsic evidence of its authenticity.

(e) The filing office shall perform the acts required by subsections (a) to (d) of this section at the time and in the manner prescribed by filing-office rule, but not later than five business days after the filing office receives the request.

(f) At least weekly, the filing office shall offer to sell or license to the public on a nonexclusive basis, in bulk, copies of all records filed in it under this part 5, in such digital or electronic medium as is from time to time available to the filing office.

Source: L. 2001: Entire article R&RE, p. 1392, § 1, effective July 1. **L. 2008:** (c) amended, p. 266, § 2, effective August 5. **L. 2009:** (d) amended, (SB 09-084), ch. 141, p. 603, § 4, effective August 5.

Editor's note: (1) This section is similar to former § 4-9-407 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado added the phrase "the name of the debtor and" in subsection (a), added a reference to "federal tax lien notice" in subsections (c)(1), (c)(2), and (c)(3), changed "two" to "five" in subsection (e), and substituted the phrase "such digital or electronic medium as is" for the phrase "every medium" in subsection (f).

OFFICIAL COMMENT

1. **Source.** Former Section 9-407; subsections (d) and (e) are new.

2. **Filing Office's Duty to Provide Information.** Former Section 9-407, dealing with obtaining information from the filing office, was bracketed to suggest to legislatures that its enactment was optional. Experience has shown that the method by which interested persons can obtain information concerning the public records should be uniform. Accordingly, the analogous provisions of this Article are not in brackets.

Most of the other changes from former Section 9-407 are for clarification, to embrace medium-neutral drafting, or to impose standards of performance on the filing office.

3. **Acknowledgments of Filing.** Subsections (a) and (b) require the filing office to acknowledge the filing of a record. Under subsection (a), the filing office is required to acknowledge the filing of a written record only upon request of the filer. Subsection (b) requires the filing office to acknowledge the filing of a non-written record even in the absence of a request from the filer.

4. **Response to Search Request.** Subsection (c)(3) requires the filing office to provide "the information contained in each financing statement" to a person who requests it. This requirement can be satisfied by providing copies, images, or reports. The requirement does not in any manner inhibit the filing office from also offering to provide less than all of the information (presumably for a lower fee) to a person who asks for less. Thus, subsection (c) accommodates the practice of providing only the type of record (e.g., initial financing statement, continuation statement), number assigned to the record, date and time of filing, and names and addresses of the debtor and secured party when a requesting person asks for no more (i.e., when the person does not ask for copies of financing statements). In contrast, the filing office's obligation under subsection (b) to provide an acknowledgment containing "the information contained in the record" is not defined by a customer's request. Thus unless the filer stipulates otherwise, to comply with subsection (b) the filing office's acknowledgment must contain all of the information in a record.

Subsection (c) assures that a minimum amount of information about filed records will be available to the public. It does not preclude a filing office from offering additional services.

5. **Lapsed and Terminated Financing Statements.** This section reflects the policy that

terminated financing statements will remain part of the filing office's data base. The filing office may remove from the data base only lapsed financing statements, and then only when at least a year has passed after lapse. See Section 9-519(g). Subsection (c)(1)(C) requires a filing office to conduct a search and report as to lapsed financing statements that have not been removed from the data base, when requested.

6. **Search by Debtor's Address.** Subsection (c)(1)(A) contemplates that, by making a single request, a searcher will receive the results of a search of the entire public record maintained by any given filing office. Addition of the bracketed language in subsection (c)(1)(A) would permit a search report limited to financing statements showing a particular address for the debtor, but only if the search request is so limited. With or without the bracketed language, this subsection does not permit the filing office to compel a searcher to limit a request by address.

7. **Medium of Communication; Certificates.** Former Article 9 provided that the filing office respond to a request for information by providing a certificate. The principle of medium-neutrality would suggest that the statute not require a written certificate. Subsection (d) follows this principle by permitting the filing office to respond by communicating "in any medium." By permitting communication "in any medium," subsection (d) is not inconsistent with a system in which persons other than filing office staff conduct searches of the filing office's (computer) records.

Some searchers find it necessary to introduce the results of their search into evidence. Because official written certificates might be introduced into evidence more easily than official communications in another medium, subsection (d) affords States the option of requiring the filing office to issue written certificates upon request. The alternative bracketed language in subsection (d) recognizes that some States may prefer to permit the filing office to respond in another medium, as long as the response can be admitted into evidence in the courts of that State without extrinsic evidence of its authenticity.

8. **Performance Standard.** The utility of the filing system depends on the ability of searchers to get current information quickly. Accordingly, subsection (e) requires that the filing office respond to a request for information no later than two business days after it receives the request. The information contained in the response must be current as of a date no earlier than three business days before the filing office receives the request. See subsection (c)(1). The failure of the filing office to comply with performance standards, such as subsection (e), has no effect on the private rights of persons affected by the filing of records.

9. **Sales of Records in Bulk.** Subsection (f), which is new, mandates that the appropriate official or the filing office sell or license the filing records to the public in bulk, on a nonexclusive basis, in every medium available to the filing office. The details of implementation are left to filing-office rules.

4-9-524. Delay by filing office. Delay by the filing office beyond a time limit prescribed by this part 5 is excused if:

(1) The delay is caused by interruption of communication or computer facilities, war, emergency conditions, failure of equipment, or other circumstances beyond control of the filing office; and

(2) The filing office exercises reasonable diligence under the circumstances.

Source: L. 2001: Entire article R&RE, p. 1393, § 1, effective July 1.

OFFICIAL COMMENT

Source. New; derived from Section 4-109.

4-9-525. Fees. (a) Except as otherwise provided in subsection (f) of this section and subject to section 24-75-402, C.R.S., fees for services rendered by the secretary of state under this part 5 shall be determined and collected pursuant to section 24-21-104, C.R.S.

(b) Except as otherwise provided in subsection (f) of this section, the fee for filing and indexing a record under this part 5 in a filing office described in section 4-9-501 (a) (1) shall not exceed:

(1) Ten dollars if the record is communicated in writing and consists of one or two pages;

(2) Fifteen dollars if the record is communicated in writing and consists of more than two pages; and

(3) Five dollars if the record is communicated by another medium authorized by filing-office rule.

(c) The number of names required to be indexed does not affect the amount of the fee in subsections (a) and (b) of this section.

(d) The secretary of state must set the fee for responding to a request for information from the secretary of state, including the fee for issuing a certificate showing whether there is on file any financing statement naming a particular debtor. The secretary of state need not set a fee for remote access to the secretary of state's data base.

(e) The fee for responding to a request for information from a filing office described in section 4-9-501 (a) (1), including for issuing a certificate showing whether there is on file any financing statement naming a particular debtor, shall not exceed:

(1) Five dollars if the request is communicated in writing; and

(2) Three dollars if the request is communicated by another medium authorized by filing-office rule.

(f) This section does not require a fee with respect to a record of a mortgage which is effective as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut under section 4-9-502 (c). However, the recording and satisfaction fees that otherwise would be applicable to the record of the mortgage apply.

Source: L. 2001: Entire article R&RE, p. 1393, § 1, effective July 1. **L. 2008:** (a) amended, p. 267, § 3, effective August 5.

Editor's note - Colorado legislative change: This section contains numerous alterations from the uniform act.

OFFICIAL COMMENT

1. **Source.** Various sections of former Part 4.

2. **Fees.** This section contains all fee requirements for filing, indexing, and responding to requests for information. Uniformity in the fee structure (but not necessarily in the amount of fees) makes this Article easier for secured parties to use and reduces the likelihood that a filed record will be rejected for failure to pay at least the correct amount of the fee. See Section 9-516(b)(2).

The costs of processing electronic records are less than those with respect to written records. Accordingly, this section mandates a lower fee as an incentive to file electronically and imposes the additional charge (if any) for multiple debtors only with respect to written records. When written records are used, this Article encourages the use of the uniform forms in Section 9-521. The fee for filing these forms should be no greater than the fee for other written records.

To make the relevant information included in a filed record more accessible once the record is found, this section mandates a higher fee for longer written records than for shorter ones. Finally, recognizing that financing statements naming more than one debtor are most often filed against a husband and wife, any additional charge for multiple debtors applies to records filed with respect to more than two debtors, rather than with respect to more than one.

4-9-526. Filing-office rules. (a) The secretary of state shall adopt and publish rules to implement this article. The filing-office rules must be:

(1) Consistent with this article; and

(2) Adopted and published in accordance with the "State Administrative Procedure Act", article 4 of title 24, C.R.S.

(b) To keep the filing-office rules and practices of the filing office in harmony with the rules and practices of filing offices in other jurisdictions that enact substantially this part 5, and to keep the technology used by the filing office compatible with the technology used by filing offices in other jurisdictions that enact substantially this part 5, the secretary of state, so far as is consistent with the purposes, policies, and provisions of this article, in adopting, amending, and repealing filing-office rules, shall:

(1) Consult with filing offices in other jurisdictions that enact substantially this part 5; and

(2) Consult the most recent version of the model rules promulgated by the international association of commercial administrators or any successor organization; and

(3) Take into consideration the rules and practices of, and the technology used by, filing offices in other jurisdictions that enact substantially this part 5.

Source: L. 2001: Entire article R&RE, p. 1394, § 1, effective July 1. **L. 2008:** (b)(2) amended, p. 267, § 4, effective August 5.

OFFICIAL COMMENT

1. **Source.** New; subsection (b) derives in part from the Uniform Consumer Credit Code (1974).

2. **Rules Required.** Operating a filing office is a complicated business, requiring many more rules and procedures than this Article can usefully provide. Subsection (a) requires the adoption of rules to carry out the provisions of Article 9. The filing-office rules must be consistent with the provisions of the statute and adopted in accordance with local procedures. The publication requirement informs secured parties about filing-office practices, aids secured parties in evaluating filing-related risks and costs, and promotes regularity of application within the filing office.

3. **Importance of Uniformity.** In today's national economy, uniformity of the policies and practices of the filing offices will reduce the costs of secured transactions substantially. The International Association of Corporate Administrators (IACA), referred to in subsection (b), is an organization whose membership includes filing officers from every State. These individuals are responsible for the proper functioning of the Article 9 filing system and have worked diligently to develop model filing-office rules, with a view toward efficiency and uniformity.

Although uniformity is an important desideratum, subsection (a) affords considerable flexibility in the adoption of filing-office rules. Each State may adopt a version of subsection (a) that reflects the desired relationship between the statewide filing office described in Section 9-501(a)(2) and the local filing offices described in Section 9-501(a)(1) and that takes into account the practices of its filing offices. Subsection (a) need not designate a single official or agency to adopt rules applicable to all filing offices, and the rules applicable to the statewide filing office need not be identical to those applicable to the local filing office. For example, subsection (a) might provide for the statewide filing office to adopt filing-office rules, and, if not prohibited by other law, the filing office might adopt one set of rules for itself and another for local offices. Or, subsection (a) might designate one official or agency to adopt rules for the statewide filing office and another to adopt rules for local filing offices.

4-9-527. Duty to report. The secretary of state shall report annually on or before June 30 to the governor and legislature on the operation of the filing office. The report must contain a statement of the extent to which:

(1) The filing-office rules are not in harmony with the rules of filing offices in other jurisdictions that enact substantially this part 5 and the reasons for these variations; and

(2) The filing-office rules are not in harmony with the most recent version of the model rules promulgated by the international association of commercial administrators, or any successor organization, and the reasons for these variations.

Source: L. 2001: Entire article R&RE, p. 1395, § 1, effective July 1. **L. 2008:** (2) amended, p. 267, § 5, effective August 5.

OFFICIAL COMMENT

1. **Source.** New; derived in part from the Uniform Consumer Credit Code (1974).

2. **Duty to Report.** This section is designed to promote compliance with the standards of performance imposed upon the filing office and with the requirement that the filing office's policies, practices, and technology be consistent and compatible with the policies, practices, and technology of other filing offices.

4-9-528. Refiling required. (a) (1) The effectiveness of a financing statement that was filed before July 1, 1996, and that has not otherwise lapsed by December 31, 1997, shall lapse in the manner provided in section 4-9-403 (2) of former article 9 of this title on December 31, 1997, unless a continuation statement was filed on or after July 1, 1996, but on or before December 31, 1997, that identified the original statement by filing office, file number, and date of filing and contains a statement indicating the types or describing the items of collateral indicated in the financing statement. If a continuation statement was filed in accordance with this paragraph (1), the effectiveness of the original financing statement

is continued for five years after the last date to which the filing would otherwise have been effective, whereupon it lapses in the manner provided in section 4-9-515 unless another continuation statement is filed pursuant to section 4-9-515 prior to such lapse.

(2) No continuation statement filed pursuant to this subsection (a) on or after July 1, 1996, shall be ineffective solely because it:

(A) Failed to identify the original statement by county, if the filing office was the office of the secretary of state and the statement so stated, or by time of filing;

(B) Indicated the types or described the items of the collateral indicated in the financing statement instead of listing the collateral of the original filing; or

(C) Failed to include a statement that the original financing statement is still effective.

(b) For purposes of the refiling provisions of this section only, a continuation statement does not have to be filed during the period beginning July 1, 1996, to December 31, 1997, when the only collateral on a financing statement is timber to be cut; minerals or other substances of value which may be extracted from the earth; fixtures; a mortgage or deed of trust effective as a fixture filing; collateral, including fixtures, of a transmitting utility; or accounts subject to section 4-9-103 (5) of former article 9 of this title.

(c) References in this section to "former article 9 of this title" are to article 9 of this title as in effect immediately before July 1, 2001.

Source: L. 2001: Entire article R&RE, p. 1395, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado added this section.

4-9-529. Electronic and other filings.

(a) (Deleted by amendment, L. 2008, p. 268, § 6.)

(b) The secretary of state shall ensure that presentation for filing may be accomplished electronically, without the necessity for the presentation of a physical original document or the image thereof, if all required information is included and readily retrievable from the data transmitted. All electronic filings shall be retained in a form that facilitates location of the information so filed and production of a true and accurate physical printout or other representation of the information so filed.

(c) The secretary of state is hereby specifically authorized to establish prepaid accounts, an electronic debit system, a system for the acceptance of credit cards or electronic funds transfers, or any combination thereof.

(d) To facilitate the filing of documents in the office of the secretary of state electronically, the secretary of state is hereby specifically authorized to adopt, by rule, technical standards governing such filings and to reject documents that do not comply with such standards. Such standards may include, without limitation, the specification of commercially available software or the dissemination of software compatible with the secretary of state's reception, storage, and retrieval system. Where national standards are available and have been promulgated by a recognized professional organization, the secretary of state shall consider and may use such national standards as the basis for the rules.

(e) (Deleted by amendment, L. 2008, p. 268, § 6.)

Source: L. 2001: Entire article R&RE, p. 1396, § 1, effective July 1. **L. 2008:** (a), (d), and (e) amended, p. 268, § 6, effective (see editor's note).

Editor's note - Colorado legislative change: (1) Colorado added this section.

(2) Section 9 of chapter 84, Session Laws of Colorado 2008, provides that the act amending subsections (a), (d), and (e) is effective simultaneously with Senate Bill 06-188. The revisor of statutes received notice on February 29, 2012, that the requirements set forth in section 9 of chapter 84, Session Laws of Colorado 2008, have been met.

4-9-530. Proper office to file certain amendments. (Repealed)

Source: L. 2001: Entire article R&RE, p. 1397, § 1, effective July 1. **L. 2002:** Entire section repealed, p. 938, § 7, effective August 7.

Editor's note - legislative change: Colorado added this section.

4-9-531. Removal of social security numbers from financing statements in the custody of the secretary of state. (a) As soon as feasible, but no later than July 1, 2003, the secretary of state shall remove social security numbers from the publicly accessible electronic records of all financing statements in the custody of the secretary that were filed with a filing office on or after April 6, 1989, and before July 1, 2001, pursuant to repealed provisions of this article that required that any such financing statement contain a social security number.

(b) A financing statement from which the secretary of state removes a social security number pursuant to subsection (a) of this section shall not be rendered insufficient or ineffective by such removal.

(c) Repealed.

Source: L. 2002: Entire section added, p. 661, § 1, effective May 28. **L. 2009:** (c) repealed, (SB 09-283), ch. 336, p. 1779, § 2, effective June 1.

Editor's note: Section 3 of chapter 336, Session Laws of Colorado 2009, provides that the act repealing subsection (c) applies to any secured transaction record in the possession of the secretary of state before, on, or after June 1, 2009.

PART 6

DEFAULT

4-9-601. Rights after default - judicial enforcement - consignor or buyer of accounts, chattel paper, payment intangibles, or promissory notes. (a) After default, a secured party has the rights provided in this part 6 and, except as otherwise provided in section 4-9-602, those provided by agreement of the parties. A secured party:

(1) May reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure; and

(2) If the collateral is documents, may proceed either as to the documents or as to the goods they cover.

(b) A secured party in possession of collateral or control of collateral under section 4-7-106, 4-9-104, 4-9-105, 4-9-106, or 4-9-107 has the rights and duties provided in section 4-9-207.

(c) The rights under subsections (a) and (b) of this section are cumulative and may be exercised simultaneously.

(d) Except as otherwise provided in subsection (g) of this section and section 4-9-605, after default, a debtor and an obligor have the rights provided in this part 6 and by agreement of the parties.

(e) If a secured party has reduced its claim to judgment, the lien of any levy that may be made upon the collateral by virtue of an execution based upon the judgment relates back to the earliest of:

(1) The date of perfection of the security interest or agricultural lien in the collateral;

(2) The date of filing a financing statement covering the collateral; or

(3) Any date specified in a statute under which the agricultural lien was created.

(f) A sale pursuant to an execution is a foreclosure of the security interest or agricultural lien by judicial procedure within the meaning of this section. A secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this article.

(g) Except as otherwise provided in section 4-9-607 (c), this part 6 imposes no duties upon a secured party that is a consignor or is a buyer of accounts, chattel paper, payment intangibles, or promissory notes.

(h) For purposes of this part 6, in taking possession of collateral by self-help, "breach of the peace" includes, but is not limited to, engaging in the following actions without the contemporaneous permission of the debtor:

(1) Entering a locked or unlocked residence or residential garage;

(2) Breaking, opening, or moving any lock, gate, or other barrier to enter enclosed real property; or

(3) Using or threatening to use violent means.

Source: L. 2001: Entire article R&RE, p. 1397, § 1, effective July 1. **L. 2006:** (b) amended, p. 503, § 44, effective September 1.

Editor's note: (1) This section is similar to former § 4-9-501 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado added subsection (h).

OFFICIAL COMMENT

1. **Source.** Former Section 9-501(1), (2), (5).

2. **Enforcement: In General.** The rights of a secured party to enforce its security interest in collateral after the debtor's default are an important feature of a secured transaction. (Note that the term "rights," as defined in Section 1-201, includes "remedies.") This Part provides those rights as well as certain limitations on their exercise for the protection of the defaulting debtor, other creditors, and other affected persons. However, subsections (a) and (d) make clear that the rights provided in this Part do not exclude other rights provided by agreement.

3. **When Remedies Arise.** Under subsection (a) the secured party's rights arise "[a]fter default." As did former Section 9-501, this Article leaves to the agreement of the parties the circumstances giving rise to a default. This Article does not determine whether a secured party's post-default conduct can constitute a waiver of default in the face of an agreement stating that such conduct shall not constitute a waiver. Rather, it continues to leave to the parties' agreement, as supplemented by law other than this Article, the determination whether a default has occurred or has been waived. See Section 1-103.

4. **Possession of Collateral; Section 9-207.** After a secured party takes possession of collateral following a default, there is no longer any distinction between a security interest that before default was nonpossessory and a security interest that was possessory before default, as under a common-law pledge. This Part generally does not distinguish between the rights of a secured party with a nonpossessory security interest and those of a secured party with a possessory security interest. However, Section 9-207 addresses rights and duties with respect to collateral in a secured party's possession. Under subsection (b) of this section, Section 9-207 applies not only to possession before default but also to possession after default. Subsection (b) also has been conformed to Section 9-207, which, unlike former Section 9-207, applies to secured parties having control of collateral.

5. **Cumulative Remedies.** Former Section 9-501(1) provided that the secured party's remedies were cumulative, but it did not explicitly provide whether the remedies could be exercised simultaneously. Subsection (c) permits the simultaneous exercise of remedies if the secured party acts in good faith. The liability scheme of Subpart 2 affords redress to an aggrieved debtor or obligor. Moreover, permitting the simultaneous exercise of remedies under subsection (c) does not override any non-UCC law, including the law of tort and statutes regulating collection of debts, under which the simultaneous exercise of remedies in a particular case constitutes abusive behavior or harassment giving rise to liability.

6. **Judicial Enforcement.** Under subsection (a) a secured party may reduce its claim to judgment or foreclose its interest by any available procedure outside this Article under applicable law. Subsection (e) generally follows former Section 9-501(5). It makes clear that any judicial lien that the secured party may acquire against the collateral effectively is a continuation of the original security interest (if perfected) and not the acquisition of a new interest or a transfer of property on account of a preexisting obligation. Under former Section 9-501(5), the judicial lien was stated to relate back to the date of perfection of the security interest. Subsection (e), however, provides that the lien relates back to the earlier of the date of filing or the date of perfection. This provides a secured party who enforces a security interest by judicial process with the benefit of the "first-to-file-or-perfect" priority rule of Section 9-322(a)(1).

7. **Agricultural Liens.** Part 6 provides parallel treatment for the enforcement of agricul-

tural liens and security interests. Because agricultural liens are statutory rather than consensual, this Article does draw a few distinctions between these liens and security interests. Under subsection (e), the statute creating an agricultural lien would govern whether and the date to which an execution lien relates back. Section 9-606 explains when a "default" occurs in the agricultural lien context.

8. **Execution Sales.** Subsection (f) also follows former Section 9-501(5). It makes clear that an execution sale is an appropriate method of foreclosure contemplated by this Part. However, the sale is governed by other law and not by this Article, and the limitations under Section 9-610 on the right of a secured party to purchase collateral do not apply.

9. **Sales of Receivables; Consignments.** Subsection (g) provides that, except as provided in Section 9-607(c), the duties imposed on secured parties do not apply to buyers of accounts, chattel paper, payment intangibles, or promissory notes. Although denominated "secured parties," these buyers own the entire interest in the property sold and so may enforce their rights without regard to the seller ("debtor") or the seller's creditors. Likewise, a true consignor may enforce its ownership interest under other law without regard to the duties that this Part imposes on secured parties. Note, however, that Section 9-615 governs cases in which a consignee's secured party (other than a consignor) is enforcing a security interest that is senior to the security interest (i.e., ownership interest) of a true consignor.

ANNOTATION

Law reviews. For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983).

Annotator's note. Since § 4-9-601 is similar to § 4-9-501 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

In an action to recover a deficiency judgment, the burden is upon the secured party to prove the amount of the deficiency. Cmty. Mgt. Ass'n of Colo. Springs, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973).

A secured creditor need not "elect" his choice of remedies. He may pursue those methods of collection afforded under the code or through judicial processes otherwise available. Nor by effectuating the latter course of action does the creditor relinquish any rights obtained by virtue of his security interest. Bilar, Inc. v. Sherman, 40 Colo. App. 38, 572 P.2d 489 (1977).

Creditor is not required to make election of remedies, as rights and remedies of subsection (1) are cumulative. Wiley v. Bank of Fountain Valley, 632 P.2d 282 (Colo. App. 1981); Flexisystems, Inc. v. Am. Standards Testing Bureau, Inc., 847 P.2d 207 (Colo. App. 1992).

Creditor may proceed against real and personal property separately. Subsection (4) does not prohibit a creditor from proceeding against both real and personal property collateral simultaneously in separate proceedings. Wiley v. Bank of Fountain Valley, 632 P.2d 282 (Colo. App. 1981).

"Debtor" includes a guarantor and, as a debtor, the guarantor may not waive debtor's right to insist on a commercially reasonable disposition of collateral. May v. Women's Bank, N.A., 807 P.2d 1145 (Colo. 1991).

Section 4-9-504 is made inoperative by this section with respect to water stock foreclosed as a part of real estate security. Kinoshita v. North Denver Bank, 181 Colo. 183, 508 P.2d 1264 (1973).

Possession of chattels subject to security agreement. Secured party should have been granted immediate possession of chattels which were subject to the security agreement where the memorandum of agreement between the parties provided for foreclosure under the uniform commercial code. Alexander Dawson, Inc. v. Sage Creek Canyon Co., 37 Colo. App. 339, 546 P.2d 969 (1976).

A secured creditor who does not have possession of his security need not be granted a hearing before seizure of his security under a prior tax lien. Antonoff v. City & County of Denver, 195 Colo. 227, 577 P.2d 281 (1978).

Notice required under § 4-9-504 (3) may not be waived. United Bank v. Reed, 635 P.2d 922 (Colo. App. 1981).

Presumption that proceeds from sale without notice equal balance owing. Where there is no notice prior to sale of collateral, it is rebuttably presumed that the value of the collateral sold is equal to the balance owing on any notes. To rebut the presumption, the secured party has the burden of proving, by other evidence, the market value of the collateral and that, after application of that amount, there was a balance still owing on the notes. United Bank v. Reed, 635 P.2d 922 (Colo. App. 1981).

Applied in First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980); Hollemon v. Murray, 666 P.2d 1107 (Colo. App. 1982).

4-9-602. Waiver and variance of rights and duties. Except as otherwise provided in section 4-9-624, to the extent that they give rights to a debtor or obligor and impose duties on a secured party, the debtor or obligor may not waive or vary the rules stated in the following listed sections:

(1) Section 4-9-207 (b) (4) (C), which deals with use and operation of the collateral by the secured party;

(2) Section 4-9-210, which deals with requests for an accounting and requests concerning a list of collateral and statement of account;

(3) Section 4-9-607 (c), which deals with collection and enforcement of collateral;

(4) Sections 4-9-608 (a) and 4-9-615 (c) to the extent that they deal with application or payment of noncash proceeds of collection, enforcement, or disposition;

(5) Sections 4-9-608 (a) and 4-9-615 (d) to the extent that they require accounting for or payment of surplus proceeds of collateral;

(6) Section 4-9-609 to the extent that it imposes upon a secured party that takes possession of collateral without judicial process the duty to do so without breach of the peace;

(7) Sections 4-9-610 (b), 4-9-611, 4-9-613, and 4-9-614, which deal with disposition of collateral;

(8) Section 4-9-615 (f), which deals with calculation of a deficiency or surplus when a disposition is made to the secured party, a person related to the secured party, or a secondary obligor;

(9) Section 4-9-616, which deals with explanation of the calculation of a surplus or deficiency;

(10) Section 4-9-620, 4-9-621, and 4-9-622, which deal with acceptance of collateral in satisfaction of obligation;

(11) Section 4-9-623, which deals with redemption of collateral;

(12) Section 4-9-624, which deals with permissible waivers; and

(13) Sections 4-9-625 and 4-9-626, which deal with the secured party's liability for failure to comply with this article.

Source: L. 2001: Entire article R&RE, p. 1398, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-501 (3) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-501(3).

2. **Waiver: In General.** Section 1-102(3) addresses which provisions of the UCC are mandatory and which may be varied by agreement. With exceptions relating to good faith, diligence, reasonableness, and care, immediate parties, as between themselves, may vary its provisions by agreement. However, in the context of rights and duties after default, our legal system traditionally has looked with suspicion on agreements that limit the debtor's rights and free the secured party of its duties. As stated in former Section 9-501, Comment 4, "no mortgage clause has ever been allowed to clog the equity of redemption." The context of default offers great opportunity for overreaching. The suspicious attitudes of the courts have been grounded in common sense. This section, like former Section 9-501(3), codifies this long-standing and deeply rooted attitude. The specified rights of the debtor and duties of the secured party may not be waived or varied except as stated. Provisions that are not specified in this section are subject to the general rules in Section 1-102(3).

3. **Nonwaivable Rights and Duties.** This section revises former Section 9-501(3) by restricting the ability to waive or modify additional specified rights and duties: (i) duties under Section 9-207(b)(4)(C), which deals with the use and operation of consumer goods, (ii) the right to a response to a request for an accounting, concerning a list of collateral, or concerning a statement of account (Section 9-210), (iii) the duty to collect collateral in a commercially reasonable manner (Section 9-607), (iv) the implicit duty to refrain from a breach of the peace in taking possession of collateral under Section 9-609, (v) the duty to apply noncash proceeds of collection or disposition in a commercially reasonable manner (Sections 9-608 and 9-615), (vi) the right to a special method of calculating a surplus or deficiency in certain dispositions to a secured party, a person related to secured party, or a secondary obligor (Section 9-615), (vii) the duty to give an explanation of the calculation of

a surplus or deficiency (Section 9-616), (viii) the right to limitations on the effectiveness of certain waivers (Section 9-624), and (ix) the right to hold a secured party liable for failure to comply with this Article (Sections 9-625 and 9-626). For clarity and consistency, this Article uses the term "waive or vary" instead of "renounc[e] or modify[]," which appeared in former Section 9-504(3).

This section provides generally that the specified rights and duties "may not be waived or varied." However, it does not restrict the ability of parties to agree to settle, compromise, or renounce claims for past conduct that may have constituted a violation or breach of those rights and duties, even if the settlement involves an express "waiver."

[Section 9-610(c) limits the circumstances under which a secured party may purchase at its own private disposition. Transactions of this kind are equivalent to "strict foreclosures" and are governed by Sections 9-620, 9-621, and 9-622. The provisions of these sections can be waived only to the extent provided in Section 9-624(b). See Section 9-602.]

Note: The bracketed language takes effect July 1, 2013.

4. **Waiver by Debtors and Obligors.** The restrictions on waiver contained in this section apply to obligors as well as debtors. This resolves a question under former Article 9 as to whether secondary obligors, assuming that they were "debtors" for purposes of former Part 5, were permitted to waive, under the law of suretyship, rights and duties under that Part.

5. **Certain Post-Default Waivers.** Section 9-624 permits post-default waivers in limited circumstances. These waivers must be made in agreements that are authenticated. Under Section 1-201, an "'agreement' means the bargain of the parties in fact." In considering waivers under Section 9-624 and analogous agreements in other contexts, courts should carefully scrutinize putative agreements that appear in records that also address many additional or unrelated matters.

ANNOTATION

Law reviews. For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983).

Annotator's note. Section 4-9-602 is similar to § 4-9-501 as it existed prior to the 2001 repeal and reenactment of this article. Relevant cases construing § 4-9-501 have been included in the annotations to § 4-9-601.

4-9-603. Agreement on standards concerning rights and duties. (a) The parties may determine by agreement the standards measuring the fulfillment of the rights of a debtor or obligor and the duties of a secured party under a rule stated in section 4-9-602 if the standards are not unreasonable.

(b) Subsection (a) of this section does not empower the parties to set standards affecting the duty under section 4-9-609 to refrain from breaching the peace.

Source: L. 2001: Entire article R&RE, p. 1399, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-501 (3) as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado did not adopt the word "manifestly" before the word "unreasonable" in subsection (a) and substituted the phrase "empower the parties to set standards affecting" for the phrase "apply to" in subsection (b).

OFFICIAL COMMENT

1. **Source.** Former Section 9-501(3).

2. **Limitation on Ability to Set Standards.** Subsection (a), like former Section 9-501(3), permits the parties to set standards for compliance with the rights and duties under this Part if the standards are not "manifestly unreasonable." Under subsection (b), the parties are not permitted to set standards measuring fulfillment of the secured party's duty to take collateral without breaching the peace.

4-9-604. Procedure if security agreement covers real property or fixtures. (a) If a security agreement covers both personal and real property, a secured party may proceed:

(1) Under this part 6 as to the personal property without prejudicing any rights with respect to the real property; or

(2) As to both the personal property and the real property in accordance with the rights with respect to the real property, in which case the other provisions of this part 6 do not apply.

(b) Subject to subsection (c) of this section, if a security agreement covers goods that are or become fixtures, a secured party may proceed:

(1) Under this part 6; or

(2) In accordance with the rights with respect to real property, in which case the other provisions of this part 6 do not apply.

(c) Subject to the other provisions of this part 6, if a secured party holding a security interest in fixtures has priority over all owners and encumbrancers of the real property, the secured party, after default, may remove the collateral from the real property.

(d) A secured party that removes collateral shall promptly reimburse any encumbrancer or owner of the real property for the cost of repair of any physical injury caused by the removal. The secured party need not reimburse the encumbrancer or owner for any diminution in value of the real property caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation to reimburse.

Source: L. 2001: Entire article R&RE, p. 1400, § 1, effective July 1.

Editor's note: (1) The provisions of this section are similar to former §§ 4-9-313 (8) and 4-9-501 (4) as they existed prior to 2001.

(2) **Colorado legislative change:** Colorado did not adopt the phrase "other than the debtor" after the word "property" in the first sentence in subsection (d).

OFFICIAL COMMENT

1. **Source.** Former Sections 9-501(4), 9-313(8).

2. **Real-Property-Related Collateral.** The collateral in many transactions consists of both real and personal property. In the interest of simplicity, speed, and economy, subsection (a), like former Section 9-501(4), permits (but does not require) the secured party to proceed as to both real and personal property in accordance with its rights and remedies with respect to the real property. Subsection (a) also makes clear that a secured party who exercises rights under Part 6 with respect to personal property does not prejudice any rights under real-property law.

This Article does not address certain other real-property-related problems. In a number of States, the exercise of remedies by a creditor who is secured by both real property and non-real property collateral is governed by special legal rules. For example, under some anti-deficiency laws, creditors risk loss of rights against personal property collateral if they err in enforcing their rights against the real property. Under a "one-form-of-action" rule (or rule against splitting a cause of action), a creditor who judicially enforces a real property mortgage and does not proceed in the same action to enforce a security interest in personalty may (among other consequences) lose the right to proceed against the personalty. Although statutes of this kind create impediments to enforcement of security interests, this Article does not override these limitations under other law.

3. **Fixtures.** Subsection (b) is new. It makes clear that a security interest in fixtures may be enforced either under real-property law or under any of the applicable provisions of Part 6, including sale or other disposition either before or after removal of the fixtures (see subsection (c)). Subsection (b) also serves to overrule cases holding that a secured party's only remedy after default is the removal of the fixtures from the real property. See, e.g., *Maplewood Bank & Trust v. Sears, Roebuck & Co.*, 625 A.2d 537 (N.J. Super. Ct. App. Div. 1993).

Subsection (c) generally follows former Section 9-313(8). It gives the secured party the right to remove fixtures under certain circumstances. A secured party whose security interest in fixtures has priority over owners and encumbrancers of the real property may remove the collateral from the real property. However, subsection (d) requires the secured party to reimburse any owner (other than the debtor) or encumbrancer for the cost of repairing any physical injury caused by the removal. This right to reimbursement is implemented by the last sentence of subsection (d), which gives the owner or encumbrancer a right to security or indemnity as a condition for giving permission to remove.

ANNOTATION

Law reviews. For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

4-9-605. Unknown debtor or secondary obligor. A secured party does not owe a duty based on its status as secured party:

(1) To a person that is a debtor or obligor, unless the secured party knows:

(A) That the person is a debtor or obligor;

(B) The identity of the person; and

(C) How to communicate with the person; or

(2) To a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:

(A) That the person is a debtor; and

(B) The identity of the person.

Source: L. 2001: Entire article R&RE, p. 1400, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Duties to Unknown Persons.** This section relieves a secured party from duties owed to a debtor or obligor, if the secured party does not know about the debtor or obligor. Similarly, it relieves a secured party from duties owed to a secured party or lienholder who has filed a financing statement against the debtor, if the secured party does not know about the debtor. For example, a secured party may be unaware that the original debtor has sold the collateral subject to the security interest and that the new owner has become the debtor. If so, the secured party owes no duty to the new owner (debtor) or to a secured party who has filed a financing statement against the new owner. This section should be read in conjunction with the exculpatory provisions in Section 9-628. Note that it relieves a secured party not only from duties arising under this Article but also from duties arising under other law by virtue of the secured party's status as such under this Article, unless the other law otherwise provides.

4-9-606. Time of default for agricultural lien. For purposes of this part 6, a default occurs in connection with an agricultural lien at the time the secured party becomes entitled to enforce the lien in accordance with the statute under which it was created.

Source: L. 2001: Entire article R&RE, p. 1401, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Time of Default.** Remedies under this Part become available upon the debtor's "default." See Section 9-601. This section explains when "default" occurs in the agricultural-lien context. It requires one to consult the enabling statute to determine when the lienholder is entitled to enforce the lien.

4-9-607. Collection and enforcement by secured party. (a) If so agreed, and in any event after default, a secured party:

(1) May notify an account debtor or other person obligated on collateral to make payment or otherwise render performance to or for the benefit of the secured party;

(2) May take any proceeds to which the secured party is entitled under section 4-9-315;

(3) May enforce the obligations of an account debtor or other person obligated on collateral and exercise the rights of the debtor with respect to the obligation of the account debtor or other person obligated on collateral to make payment or otherwise render performance to the debtor, and with respect to any property that secures the obligations of the account debtor or other person obligated on the collateral;

(4) If it holds a security interest in a deposit account perfected by control under section

4-9-104 (a) (1), may apply the balance of the deposit account to the obligation secured by the deposit account; and

(5) If it holds a security interest in a deposit account perfected by control under section 4-9-104 (a) (2) or (3), may instruct the bank to pay the balance of the deposit account to or for the benefit of the secured party.

(b) If necessary to enable a secured party to exercise under paragraph (3) of subsection (a) of this section the right of a debtor to enforce a mortgage nonjudicially, the secured party may record in the office in which a record of the mortgage is recorded:

(1) A copy of the security agreement that creates or provides for a security interest in the obligation secured by the mortgage; and

(2) The secured party's sworn affidavit in recordable form stating that:

(A) A default has occurred; and

Editor's note: This version of subparagraph (A) is effective until July 1, 2013.

(A) A default has occurred with respect to the obligation secured by the mortgage; and

Editor's note: This version of subparagraph (A) is effective July 1, 2013.

(B) The secured party is entitled to enforce the mortgage nonjudicially.

(c) A secured party shall proceed in a commercially reasonable manner if the secured party:

(1) Undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral; and

(2) Is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or a secondary obligor.

(d) A secured party may deduct from the collections made pursuant to subsection (c) of this section reasonable expenses of collection and enforcement, including reasonable attorney's fees and reasonable legal expenses incurred by the secured party.

(e) This section does not determine whether an account debtor, bank, or other person obligated on collateral owes a duty to a secured party.

Source: L. 2001: Entire article R&RE, p. 1401, § 1, effective July 1. **L. 2012:** (b)(2)(A) amended, (HB 12-1262), ch. 170, p. 604, § 15, effective July 1, 2013.

Editor's note: This section is similar to former § 4-9-502 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-502; subsections (b), (d), and (e) are new.

2. **Collections: In General.** Collateral consisting of rights to payment is not only the most liquid asset of a typical debtor's business but also is property that may be collected without any interruption of the debtor's business This situation is far different from that in which collateral is inventory or equipment, whose removal may bring the business to a halt. Furthermore, problems of valuation and identification, present with collateral that is tangible personal property, frequently are not as serious in the case of rights to payment and other intangible collateral. Consequently, this section, like former Section 9-502, recognizes that financing through assignments of intangibles lacks many of the complexities that arise after default in other types of financing. This section allows the assignee to liquidate collateral by collecting whatever may become due on the collateral, whether or not the method of collection contemplated by the security arrangement before default was direct (i.e., payment by the account debtor to the assignee, "notification" financing) or indirect (i.e., payment by the account debtor to the assignor, "nonnotification" financing).

3. **Scope.** The scope of this section is broader than that of former Section 9-502. It applies not only to collections from account debtors and obligors on instruments but also to enforcement more generally against all persons obligated on collateral. It explicitly provides for the secured party's enforcement of the debtor's rights in respect of the account debtor's (and other third parties') obligations and for the secured party's enforcement of supporting obligations with respect to those obligations. (Supporting obligations are components of the collateral under Section 9-203(f).) The rights of a secured party under subsection (a) include the right to enforce claims that the debtor may enjoy against others.

For example, the claims might include a breach-of-warranty claim arising out of a defect in equipment that is collateral or a secured party's action for an injunction against infringement of a patent that is collateral. Those claims typically would be proceeds of original collateral under Section 9-315.

4. **Collection and Enforcement Before Default.** Like Part 6 generally, this section deals with the rights and duties of secured parties following default. However, as did former Section 9-502 with respect to collection rights, this section also applies to the collection and enforcement rights of secured parties even if a default has not occurred, as long as the debtor has so agreed. It is not unusual for debtors to agree that secured parties are entitled to collect and enforce rights against account debtors prior to default.

5. **Collections by Junior Secured Party.** A secured party who holds a security interest in a right to payment may exercise the right to collect and enforce under this section, even if the security interest is subordinate to a conflicting security interest in the same right to payment. Whether the junior secured party has priority in the collected proceeds depends on whether the junior secured party qualifies for priority as a purchaser of an instrument (e.g., the account debtor's check) under Section 9-330(d), as a holder in due course of an instrument under Sections 3-305 and 9-331(a), or as a transferee of money under Section 9-332(a). See Sections 9-330, Comment 7; 9-331, Comment 5; and 9-332.

6. **Relationship to Rights and Duties of Persons Obligated on Collateral.** This section permits a secured party to collect and enforce obligations included in collateral in its capacity as a secured party. It is not necessary for a secured party first to become the owner of the collateral pursuant to a disposition or acceptance. However, the secured party's rights, as between it and the debtor, to collect from and enforce collateral against account debtors and others obligated on collateral under subsection (a) are subject to Section 9-341, Part 4, and other applicable law. *Neither this section nor former Section 9-502 should be understood to regulate the duties of an account debtor or other person obligated on collateral.* Subsection (e) makes this explicit. For example, the secured party may be unable to exercise the debtor's rights under an instrument if the debtor is in possession of the instrument, or under a non-transferable letter of credit if the debtor is the beneficiary. Unless a secured party has control over a letter-of-credit right and is entitled to receive payment or performance from the issuer or a nominated person under Article 5, its remedies with respect to the letter-of-credit right may be limited to the recovery of any identifiable proceeds from the debtor. This section establishes only the baseline rights of the secured party *vis-a-vis the debtor* the secured party is entitled to enforce and collect after default or earlier if so agreed.

7. **Deposit Account Collateral.** Subsections (a)(4) and (5) set forth the self-help remedy for a secured party whose collateral is a deposit account. Subsection (a)(4) addresses the rights of a secured party that is the bank with which the deposit account is maintained. That secured party automatically has control of the deposit account under Section 9-104(a)(1). After default, and otherwise if so agreed, the bank/secured party may apply the funds on deposit to the secured obligation.

If a security interest of a third party is perfected by control (Section 9-104(a)(2) or (a)(3)), then after default, and otherwise if so agreed, the secured party may instruct the bank to pay out the funds in the account. If the third party has control under Section 9-104(a)(3), the depositary institution is obliged to obey the instruction because the secured party is its customer. See Section 4-401. If the third party has control under Section 9-104(a)(2), the control agreement determines the depositary institution's obligation to obey.

If a security interest in a deposit account is unperfected, or is perfected by filing by virtue of the proceeds rules of Section 9-315, the depositary institution ordinarily owes no obligation to obey the secured party's instructions. See Section 9-341. To reach the funds without the debtor's cooperation, the secured party must use an available judicial procedure.

8. **Rights Against Mortgagor of Real Property.** Subsection (b) addresses the situation in which the collateral consists of a mortgage note (or other obligation secured by a mortgage on real property). After the debtor's (mortgagee's) default, the secured party (assignee) may wish to proceed with a nonjudicial foreclosure of the mortgage securing the note but may be unable to do so because it has not become the assignee of record. The assignee/secured party may not have taken a recordable assignment at the commencement of the transaction (perhaps the mortgage note in question was one of hundreds assigned to the secured party as collateral). Having defaulted, the mortgagee may be unwilling to sign a recordable assignment. This section enables the secured party (assignee) to become the assignee of record by recording in the applicable real-property records the security agreement and an affidavit certifying default. Of course, the secured party's rights derive from those of its debtor. Subsection (b) would not entitle the secured party to proceed with a foreclosure unless the mortgagor also were in default or the debtor (mortgagee) otherwise enjoyed the right to foreclose.

9. **Commercial Reasonableness.** Subsection (c) provides that the secured party's collection

and enforcement rights under subsection (a) must be exercised in a commercially reasonable manner. These rights include the right to settle and compromise claims against the account debtor. The secured party's failure to observe the standard of commercial reasonableness could render it liable to an aggrieved person under Section 9-625, and the secured party's recovery of a deficiency would be subject to Section 9-626. Subsection (c) does not apply if, as is characteristic of most sales of accounts, chattel paper, payment intangibles, and promissory notes, the secured party (buyer) has no right of recourse against the debtor (seller) or a secondary obligor. However, if the secured party does have a right of recourse, the commercial-reasonableness standard applies to collection and enforcement even though the assignment to the secured party was a "true" sale. The obligation to proceed in a commercially reasonable manner arises because the collection process affects the extent of the seller's recourse liability, not because the seller retains an interest in the sold collateral (the seller does not). Concerning classification of a transaction, see Section 9-109, Comment 4.

10. **Attorney's Fees and Legal Expenses.** The phrase "reasonable attorney's fees and legal expenses," which appears in subsection (d), includes only those fees and expenses incurred in proceeding against account debtors or other third parties. The secured party's right to recover these expenses from the collections arises automatically under this section. The secured party also may incur other attorney's fees and legal expenses in proceeding against the debtor or obligor. Whether the secured party has a right to recover those fees and expenses depends on whether the debtor or obligor has agreed to pay them, as is the case with respect to attorney's fees and legal expenses under Sections 9-608(a)(1)(A) and 9-615(a)(1). The parties also may agree to allocate a portion of the secured party's overhead to collection and enforcement under subsection (d) or Section 9-608(a).

ANNOTATION

Law reviews. For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982).

Annotator's note. Since § 4-9-607 is similar to § 4-9-502 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Bank's security interest in taxpayer's accounts payable and contract rights was not choate under Colorado law so as to have priority over federal tax lien because bank failed to take action required under this section before the notice and filing of the federal tax lien. U.S. v. Central Bank of Denver, 843 F.2d 1300 (10th Cir. 1988).

Applied in First Nat'l Bank v. District Court, 653 P.2d 1123 (Colo. 1982).

4-9-608. Application of proceeds of collection or enforcement - liability for deficiency and right to surplus. (a) If a security interest or agricultural lien secures payment or performance of an obligation, the following rules apply:

(1) A secured party shall apply or pay over for application the cash proceeds of collection or enforcement under section 4-9-607 in the following order to:

(A) The reasonable expenses of collection and enforcement and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and reasonable legal expenses incurred by the secured party;

(B) The satisfaction of obligations secured by the security interest or agricultural lien under which the collection or enforcement is made; and

(C) The satisfaction of obligations secured by any subordinate security interest in or other lien on the collateral subject to the security interest or agricultural lien under which the collection or enforcement is made if the secured party receives an authenticated demand for proceeds before distribution of the proceeds is completed.

(2) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder complies, the secured party need not comply with the holder's demand under subparagraph (C) of paragraph (1) of this subsection (a).

(3) A secured party need not apply or pay over for application noncash proceeds of collection and enforcement under section 4-9-607 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(4) A secured party shall account to and pay a debtor for any surplus, and the obligor is liable for any deficiency.

(b) If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes, the debtor is not entitled to any surplus, and the obligor is not liable for any deficiency.

Source: L. 2001: Entire article R&RE, p. 1402, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado substituted the phrase "section 4-9-607" for the phrase "this section" in subsections (a)(1) and (a)(3) and added the word "reasonable" in subsection (a)(1)(A).

OFFICIAL COMMENT

1. **Source.** Subsection (a) is new; subsection (b) derives from former Section 9-502(2).

2. **Modifications of Prior Law.** Subsections (a) and (b) modify former Section 9-502(2) by explicitly providing for the application of proceeds recovered by the secured party in substantially the same manner as provided in Section 9-615(a) and (e) for dispositions of collateral.

3. **Surplus and Deficiency.** Subsections (a)(4) and (b) omit, as unnecessary, the references contained in former Section 9-502(2) to agreements varying the baseline rules on surplus and deficiency. The parties are always free to agree that an obligor will not be liable for a deficiency, even if the collateral secures an obligation, and that an obligor is liable for a deficiency, even if the transaction is a sale of receivables. For parallel provisions, see Section 9-615(d) and (e).

4. **Noncash Proceeds.** Subsection (a)(3) addresses the situation in which an enforcing secured party receives noncash proceeds.

Example: An enforcing secured party receives a promissory note from an account debtor who is unable to pay an account when it is due. The secured party accepts the note in exchange for extending the date on which the account debtor's obligation is due. The secured party may wish to credit its debtor (the assignor) with the principal amount of the note upon receipt of the note, but probably will prefer to credit the debtor only as and when the note is paid.

Under subsection (a)(3), the secured party is under no duty to apply the note or its value to the outstanding obligation unless its failure to do so would be commercially unreasonable. If the secured party does apply the note to the outstanding obligation, however, it must do so in a commercially reasonable manner. The parties may provide for the method of application of noncash proceeds by agreement, if the method is not manifestly unreasonable. See Section 9-603. This section does not explain when the failure to apply noncash proceeds would be commercially unreasonable; it leaves that determination to case-by-case adjudication. In the example, the secured party appears to have accepted the account debtor's note in order to increase the likelihood of payment and decrease the likelihood that the account debtor would dispute its obligation. Under these circumstances, it may well be commercially reasonable for the secured party to credit its debtor's obligations only as and when cash proceeds are collected from the account debtor, especially given the uncertainty that attends the account debtor's eventual payment. For an example of a secured party's receipt of noncash proceeds in which it may well be commercially unreasonable for the secured party to delay crediting its debtor's obligations with the value of noncash proceeds, see Section 9-615, Comment 3.

When the secured party is not required to "apply or pay over for application noncash proceeds," the proceeds nonetheless remain collateral subject to this Article. If the secured party were to dispose of them, for example, appropriate notification would be required (see Section 9-611), and the disposition would be subject to the standards provided in this Part (see Section 9-610). Moreover, a secured party in possession of the noncash proceeds would have the duties specified in Section 9-207.

5. **No Effect on Priority of Senior Security Interest.** The application of proceeds required by subsection (a) does not affect the priority of a security interest in collateral which is senior to the interest of the secured party who is collecting or enforcing collateral under Section 9-607. Although subsection (a) imposes a duty to apply proceeds to the enforcing secured party's expenses and to the satisfaction of the secured obligations owed to it and to subordinate secured parties, that duty applies only among the enforcing secured party and those persons. Concerning the priority of a junior secured party who collects and enforces collateral, see Section 9-607, Comment 5.

4-9-609. Secured party's right to take possession after default. (a) After default, a secured party:

(1) May take possession of the collateral; and

(2) Without removal, may render equipment unusable and dispose of collateral on a debtor's premises under section 4-9-610.

(b) A secured party may proceed under subsection (a) of this section:

(1) Pursuant to judicial process; or

(2) Without judicial process, if it proceeds without breach of the peace.

(c) If so agreed, and in any event after default, a secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties.

(d) If the collateral is a manufactured home or trailer coach, as defined in section 42-1-102 (106), C.R.S., and is used and occupied by the debtor as a place of residence, the secured party may take possession of the collateral pursuant to this section without judicial process only if there is clear and convincing evidence that the debtor has vacated or abandoned the collateral or the debtor voluntarily surrenders the collateral to the secured party.

(e) In exercising its rights under paragraph (2) of subsection (a) of this section with respect to collateral, a secured party may not disable or render unusable any computer program or other similar device embedded in the collateral if immediate injury to any person or property is a reasonably foreseeable consequence of such action. Any secured party who disables or renders unusable such a computer program or other similar device in such circumstances shall be liable in accordance with applicable rules of law to any person who sustains an injury to person or property as a reasonably foreseeable result of the secured party's action.

Source: L. 2001: Entire article R&RE, p. 1403, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-503 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado added subsections (d) and (e).

OFFICIAL COMMENT

1. **Source.** Former Section 9-503.

2. **Secured Party's Right to Possession.** This section follows former Section 9-503 and earlier uniform legislation. It provides that the secured party is entitled to take possession of collateral after default.

3. **Judicial Process; Breach of Peace.** Subsection (b) permits a secured party to proceed under this section without judicial process if it does so "without breach of the peace." Although former Section 9-503 placed the same condition on a secured party's right to take possession of collateral, subsection (b) extends the condition to the right provided in subsection (a)(2) as well. Like former Section 9-503, this section does not define or explain the conduct that will constitute a breach of the peace, leaving that matter for continuing development by the courts. In considering whether a secured party has engaged in a breach of the peace, however, courts should hold the secured party responsible for the actions of others taken on the secured party's behalf, including independent contractors engaged by the secured party to take possession of collateral.

This section does not authorize a secured party who repossesses without judicial process to utilize the assistance of a law-enforcement officer. A number of cases have held that a repossessing secured party's use of a law-enforcement officer without benefit of judicial process constituted a failure to comply with former Section 9-503.

4. **Damages for Breach of Peace.** Concerning damages that may be recovered based on a secured party's breach of the peace in connection with taking possession of collateral, see Section 9-625, Comment 3.

5. **Multiple Secured Parties.** More than one secured party may be entitled to take possession of collateral under this section. Conflicting rights to possession among secured parties are resolved by the priority rules of this Article. Thus, a senior secured party is entitled to possession as against a junior claimant. Non-UCC law governs whether a junior secured party in possession of collateral is liable to the senior in conversion. Normally, a junior who refuses to relinquish possession of collateral upon the demand of a secured party having a superior possessory right to the collateral would be liable in conversion.

6. **Secured Party's Right to Disable and Dispose of Equipment on Debtor's Premises.** In the case of some collateral, such as heavy equipment, the physical removal from the debtor's plant and the storage of the collateral pending disposition may be impractical or unduly expensive. This section follows former Section 9-503 by providing that, in lieu of removal, the

secured party may render equipment unusable or may dispose of collateral on the debtor's premises. Unlike former Section 9-503, however, this section explicitly conditions these rights on the debtor's default. Of course, this section does not validate unreasonable action by a secured party. Under Section 9-610, all aspects of a disposition must be commercially reasonable.

7. **Debtor's Agreement to Assemble Collateral.** This section follows former Section 9-503 also by validating a debtor's agreement to assemble collateral and make it available to a secured party at a place that the secured party designates. Similar to the treatment of agreements to permit collection prior to default under Section 9-607 and former 9-502, however, this section validates these agreements whether or not they are conditioned on the debtor's default. For example, a debtor might agree to make available to a secured party, from time to time, any instruments or negotiable documents that the debtor receives on account of collateral. A court should not infer from this section's validation that a debtor's agreement to assemble and make available collateral would not be enforceable under other applicable law.

8. **Agreed Standards.** Subject to the limitation imposed by Section 9-603(b), this section's provisions concerning agreements to assemble and make available collateral and a secured party's right to disable equipment and dispose of collateral on a debtor's premises are likely topics for agreement on standards as contemplated by Section 9-603.

ANNOTATION

Annotator's note. Since § 4-9-609 is similar to § 4-9-503 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Law reviews. For comment discussing 14th amendment "state action" ramifications and constitutionality of self-help repossessions under the U.C.C., see 44 U. Colo. L. Rev. 389 (1973). For comment discussing whether repossession by a secured creditor pursuant to statutory and contractual provisions constitutes state action, see 50 Den. L.J. 261 (1973). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983). For article, "A Review of Agricultural Law: Hard Times and Hard Choices", see 15 Colo. Law. 629 (1986). For article, "The Colorado Farm Homestead Protection Act", see 15 Colo. Law 1642 (1986). For article, "Agricultural Lending in a Troubled Economy", see 16 Colo. Law. 1773 (1987). For article, "The Agricultural Credit Act of 1987", see 17 Colo. Law. 611 (1988).

As applied to facts of case section not unconstitutional. Where the secured creditor gave the debtor every opportunity to avoid default, and only after the debtor refused to make any effort to pay and he was informed by the creditor that the creditor had no choice but to repossess, did the creditor resort to repossession, as applied to these facts, this section is not unconstitutional for violating due process. John Deere Co. v. Catalano, 186 Colo. 101, 525 P.2d 1153 (1974).

Authorization of self-help repossessions is not enough to sufficiently involve the state in the acts of repossessors for their acts to be action "under color of" state law. Kirksey v. Theilig, 351 F. Supp. 727 (D. Colo. 1972).

Article 9 does not determine location of title after default. People ex rel. VanMeveren v. District Court, 619 P.2d 494 (Colo. 1980).

Traditional state rule allows repossession of security. In Colorado, as elsewhere, the state's traditional rule has been to allow the secured creditor to repossess the security if the contract so provides and the repossession does not "breach the peace". John Deere Co. v. Catalano, 186 Colo. 101, 525 P.2d 1153 (1974).

Right to possession is not limited by this section to the creditor whose security interest has the higher priority. Western Nat'l Bank v. ABC Drilling Co., 42 Colo. App. 407, 599 P.2d 942 (1979).

Section adds nothing if parties previously agree on such remedy. While the enactment of this section provides for self-help repossession in absence of contrary contract provisions, it adds nothing to the situation where the parties have previously agreed on such a remedy and the procedure is carried out without significant state help. John Deere Co. v. Catalano, 186 Colo. 101, 525 P.2d 1153 (1974).

No right to jury trial before repossession. Although C.R.C.P. 38 provides that a party is entitled to a jury trial upon demand in an action for the recovery of specific real or personal property, the rule is not intended to extend to actions involving the repossession of collateral by a secured party. Western Nat'l Bank v. ABC Drilling Co., 42 Colo. App. 407, 599 P.2d 942 (1979).

In event of default, voluntary delivery of collateral to creditor constitutes a repossession and does not remove the matter from the UCC. Tajalli v. Gharibi, 758 P.2d 190 (Colo. App. 1988).

Applied in First Nat'l Bank v. District Court, 653 P.2d 1123 (Colo. 1982); Layne v. Fort Carson Nat'l Bank, 655 P.2d 856 (Colo. App. 1982); Wynn v. Adams County Bank, 761 P.2d 234 (Colo. App. 1988).

4-9-610. Disposition of collateral after default. (a) After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.

(b) Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place and on any terms.

(c) A secured party may purchase collateral:

(1) At a public disposition; or

(2) At a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

(d) A contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract.

(e) A secured party may disclaim or modify warranties under subsection (d) of this section:

(1) In a manner that would be effective to disclaim or modify the warranties in a voluntary disposition of property of the kind subject to the contract of disposition; or

(2) By communicating to the purchaser, prior to completion of the transaction, a record evidencing the contract for disposition and including an express disclaimer or modification of the warranties.

(f) A record is sufficient to disclaim warranties under subsection (e) of this section if it indicates "There is no warranty relating to title, possession, quiet enjoyment, or the like in this disposition" or uses words of similar import.

Source: L. 2001: Entire article R&RE, p. 1403, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-504 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado added the phrase "prior to completion of the transaction," to subsection (e)(2).

OFFICIAL COMMENT

1. **Source.** Former Section 9-504(1), (3).

2. **Commercially Reasonable Dispositions.** Subsection (a) follows former Section 9-504 by permitting a secured party to dispose of collateral in a commercially reasonable manner following a default. Although subsection (b) permits both public and private dispositions, [including public and private dispositions conducted over the Internet,] "every aspect of a disposition . . . must be commercially reasonable." This section encourages private dispositions on the assumption that they frequently will result in higher realization on collateral for the benefit of all concerned. Subsection (a) does not restrict dispositions to sales; collateral may be sold, leased, licensed, or otherwise disposed. Section 9-627 provides guidance for determining the circumstances under which a disposition is "commercially reasonable."

Note: The bracketed language takes effect July 1, 2013.

3. **Time of Disposition.** This Article does not specify a period within which a secured party must dispose of collateral. This is consistent with this Article's policy to encourage private dispositions through regular commercial channels. It may, for example, be prudent not to dispose of goods when the market has collapsed. Or, it might be more appropriate to sell a large inventory in parcels over a period of time instead of in bulk. Of course, under subsection (b) every aspect of a disposition of collateral must be commercially reasonable. This requirement explicitly includes the "method, manner, time, place and other terms." For example, if a secured party does not proceed under Section 9-620 and holds collateral for a long period of time without disposing of it, and if there is no good reason for not making a prompt disposition, the secured party may be determined not to have acted in a "commercially reasonable" manner. See also Section 1-203 (general obligation of good faith).

4. **Pre-Disposition Preparation and Processing.** Former Section 9-504(1) appeared to give the secured party the choice of disposing of collateral either "in its then condition or following any commercially reasonable preparation or processing." Some courts held that the "commercially reasonable" standard of former Section 9-504(3) nevertheless could impose an affirmative duty on the secured party to process or prepare the collateral prior to disposition. Subsection (a) retains the substance of the quoted

language. Although courts should not be quick to impose a duty of preparation or processing on the secured party, subsection (a) does not grant the secured party the right to dispose of the collateral "in its then condition" under *all* circumstances. A secured party may not dispose of collateral "in its then condition" when, taking into account the costs and probable benefits of preparation or processing and the fact that the secured party would be advancing the costs at its risk, it would be commercially unreasonable to dispose of the collateral in that condition.

5. **Disposition by Junior Secured Party.** Disposition rights under subsection (a) are not limited to first-priority security interests. Rather, any secured party as to whom there has been a default enjoys the right to dispose of collateral under this subsection. The exercise of this right by a secured party whose security interest is subordinate to that of another secured party does not of itself constitute a conversion or otherwise give rise to liability in favor of the holder of the senior security interest. Section 9-615 addresses application of the proceeds of a disposition by a junior secured party. Under Section 9-615(a), a junior secured party owes no obligation to apply the proceeds of disposition to the satisfaction of obligations secured by a senior security interest. Section 9-615(g) builds on this general rule by protecting certain juniors from claims of a senior concerning cash proceeds of the disposition. Even if a senior were to have a non-Article 9 claim to proceeds of a junior's disposition, Section 9-615(g) would protect a junior that acts in good faith and without knowledge that its actions violate the rights of a senior party. Because the disposition by a junior would not cut off a senior's security interest or other lien (see Section 9-617), in many (probably most) cases the junior's receipt of the cash proceeds would not violate the rights of the senior.

The holder of a senior security interest is entitled, by virtue of its priority, to take possession of collateral from the junior secured party and conduct its own disposition, provided that the senior enjoys the right to take possession of the collateral from the debtor. See Section 9-609. The holder of a junior security interest normally must notify the senior secured party of an impending disposition. See Section 9-611. Regardless of whether the senior receives a notification from the junior, the junior's disposition does not of itself discharge the senior's security interest. See Section 9-617. Unless the senior secured party has authorized the disposition free and clear of its security interest, the senior's security interest ordinarily will survive the disposition by the junior and continue under Section 9-315(a). If the senior enjoys the right to repossess the collateral from the debtor, the senior likewise may recover the collateral from the transferee.

When a secured party's collateral is encumbered by another security interest or other lien, one of the claimants may seek to invoke the equitable doctrine of marshaling. As explained by the Supreme Court, that doctrine "rests upon the principle that a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds." *Meyer v. United States*, 375 U.S. 233, 236 (1963), quoting *Sowell v. Federal Reserve Bank*, 268 U.S. 449, 456-57 (1925). The purpose of the doctrine is "to prevent the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security." Id. at 237. Because it is an equitable doctrine, marshaling "is applied only when it can be equitably fashioned as to all of the parties" having an interest in the property. Id. This Article leaves courts free to determine whether marshaling is appropriate in any given case. See Section 1-103.

6. **Security Interests of Equal Rank.** Sometimes two security interests enjoy the same priority. This situation may arise by contract, e.g., pursuant to "equal and ratable" provisions in indentures, or by operation of law. See Section 9-328(6). This Article treats a security interest having equal priority like a senior security interest in many respects. Assume, for example, that SP-X and SP-Y enjoy equal priority, SP-W is senior to them, and SP-Z is junior. If SP-X disposes of the collateral under this section, then (i) SP-W's and SP-Y's security interests survive the disposition but SP-Z's does not, see Section 9-617, and (ii) neither SP-W nor SP-Y is entitled to receive a distribution of proceeds, but SP-Z is. See Section 9-615(a)(3).

When one considers the ability to obtain possession of the collateral, a secured party with equal priority is unlike a senior secured party. As the senior secured party, SP-W should enjoy the right to possession as against SP-X. See Section 9-609, Comment 5. If SP-W takes possession and disposes of the collateral under this section, it is entitled to apply the proceeds to satisfy its secured claim. SP-Y, however, should not have such a right to take possession from SP-X; otherwise, once SP-Y took possession from SP-X, SP-X would have the right to get possession from SP-Y, which would be obligated to redeliver possession to SP-X, and so on. Resolution of this problem is left to the parties and, if necessary, the courts.

7. **Public vs. Private Dispositions.** This Part maintains two distinctions between "public" and other dispositions: (i) the secured party may buy at the former, but normally not at the latter (Section 9-610(c)), and (ii) the debtor is entitled to notification of "the time and place of a public disposition" and notification of "the time after which" a private disposition or other intended disposition is to be made (Section 9-613(1)(E)).

It does not retain the distinction under former Section 9-504(4), under which transferees in a noncomplying public disposition could lose protection more easily than transferees in other noncomplying dispositions. Instead, Section 9-617(b) adopts a unitary standard. Although the term is not defined, as used in this Article, a "public disposition" is one at which the price is determined after the public has had a meaningful opportunity for competitive bidding. "Meaningful opportunity" is meant to imply that some form of advertisement or public notice must precede the sale (or other disposition) and that the public must have access to the sale (disposition).

[A secured party's purchase of collateral at its own private disposition is equivalent to a "strict foreclosure" and is governed by Sections 9-620, 9-621, and 9-622. The provisions of these sections can be waived only to the extent provided in Section 9-624(b). See Section 9-602.]

Note: The bracketed language takes effect July 1, 2013.

8. **Investment Property.** Dispositions of investment property may be regulated by the federal securities laws. Although a "public" disposition of securities under this Article may implicate the registration requirements of the Securities Act of 1933, it need not do so. A disposition that qualifies for a "private placement" exemption under the Securities Act of 1933 nevertheless may constitute a "public" disposition within the meaning of this section. Moreover, the "commercially reasonable" requirements of subsection (b) need not prevent a secured party from conducting a foreclosure sale without the issuer's compliance with federal registration requirements.

9. **"Recognized Market."** A "recognized market," as used in subsection (c) and Section 9-611(d), is one in which the items sold are fungible and prices are not subject to individual negotiation. For example, the New York Stock Exchange is a recognized market. A market in which prices are individually negotiated or the items are not fungible is not a recognized market, even if the items are the subject of widely disseminated price guides or are disposed of through dealer auctions.

10. **Relevance of Price.** While not itself sufficient to establish a violation of this Part, a low price suggests that a court should scrutinize carefully all aspects of a disposition to ensure that each aspect was commercially reasonable. Note also that even if the disposition is commercially reasonable, Section 9-615(f) provides a special method for calculating a deficiency or surplus if (i) the transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor, and (ii) the amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

11. **Warranties.** Subsection (d) affords the transferee in a disposition under this section the benefit of any title, possession, quiet enjoyment, and similar warranties that would have accompanied the disposition by operation of non-Article 9 law had the disposition been conducted under other circumstances. For example, the Article 2 warranty of title would apply to a sale of goods, the analogous warranties of Article 2A would apply to a lease of goods, and any common-law warranties of title would apply to dispositions of other types of collateral. See, e.g., Restatement (2d), Contracts 333 (warranties of assignor).

Subsection (e) explicitly provides that these warranties can be disclaimed either under other applicable law or by communicating a record containing an express disclaimer. The record need not be written, but an oral communication would not be sufficient. See Section 9-102 (definition of "record"). Subsection (f) provides a sample of wording that will effectively exclude the warranties in a disposition under this section, whether or not the exclusion would be effective under non-Article 9 law.

The warranties incorporated by subsection (d) are those relating to "title, possession, quiet enjoyment, and the like." Depending on the circumstances, a disposition under this section also may give rise to other statutory or implied warranties, e.g., warranties of quality or fitness for purpose. Law other than this Article determines whether such other warranties apply to a disposition under this section. Other law also determines issues relating to disclaimer of such warranties. For example, a foreclosure sale of a car by a car dealer could give rise to an implied warranty of merchantability (Section 2-314) unless effectively disclaimed or modified (Section 2-316).

This section's approach to these warranties conflicts with the former Comment to Section 2-312. This Article rejects the baseline assumption that commercially reasonable dispositions under this section are out of the ordinary commercial course or peculiar. The Comment to Section 2-312 has been revised accordingly.

ANNOTATION

Law reviews. For comment, "Remedies for Failure to Notify Debtor of Disposition of Repossessed Collateral Under the U.C.C.", see 44 U. Colo. L. Rev. 221 (1972). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Commercial Law", see 55 Den. L.J.

425 (1978). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983). For article, "A Review of Agricultural Law: Hard Times and Hard Choices", see 15 Colo. Law. 629 (1986). For article, "The Colorado Farm Homestead Protection Act", see 15 Colo. Law. 1642 (1986). For article, "Agricultural Lending in a Troubled Economy", see 16 Colo. Law. 1773 (1987). For article, "The Agricultural Credit Act of 1987", see 17 Colo. Law. 611 (1988).

Annotator's note. Since § 4-9-610 is similar to § 4-9-504 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Issuance of title certificate to repossessor involves no deprivation of due process as contemplated by the fourteenth amendment or state constitution. It may be that repossession of automobiles or any other property sold on time payment with an express agreement permitting such repossession without notice may be resulting in great abuses, and controls are needed. If so, the regulation of this abuse is a matter for the general assembly, not the courts. Sifuentes v. Weed, 186 Colo. 109, 525 P.2d 1157 (1974).

Authorization of self-help repossessions is not enough to sufficiently involve the state in the acts of repossessors for their acts to be action "under color of" state law. Kirksey v. Theilig, 351 F. Supp. 727 (D. Colo. 1972).

"Disposition" of collateral connotes receipt of "proceeds". Where collateral was released to the debtor, and the creditor did not receive "proceeds", no "disposition" of the collateral took place. Silverberg v. Colantuno, 991 P.2d 280 (Colo. App. 1998).

Presumption that proceeds from sale without notice equal balance owing. Where there is no notice prior to sale of collateral, it is rebuttably presumed that the value of the collateral sold is equal to the balance owing on any notes. To rebut the presumption, the secured party has the burden of proving, by other evidence, that the market value of the collateral and that, after application of that amount, there was a balance still owing on the notes. United Bank v. Reed, 635 P.2d 922 (Colo. App. 1981); Gapter v. Kocjancic, 703 P.2d 660 (Colo. App. 1985); Tajalli v. Gharibi, 758 P.2d 190 (Colo. App. 1988).

The reason for exempting from the notice requirement a transaction where there is a recognized market is that the price on the recognized market represents the fair market value from day to day, so if there is a recognized market, theoretically, the best price at any given time is the current market price. Cmty. Mgt. Ass'n of Colo. Springs, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973).

Repossessed automobiles are not collateral of a type sold on a recognized market within the meaning of this section which excuses notification of sale in case of such collateral. Cmty. Mgt. Ass'n of Colo. Springs, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973).

Since there is no recognized market for the sale of repossessed automobiles, debtors are entitled to notice of sale of the repossessed automobile. Cmty. Mgt. Ass'n of Colo. Springs, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973).

Computer hardware is not collateral of a type sold on a recognized market within the meaning of this section which excuses notification of sale in case of such collateral. 1st Charter Lease Co. v. McAl, Inc., 679 P.2d 114 (Colo. App. 1984).

Immediate action against guarantors. Where by its terms a security document is an absolute guaranty, the obligation of the guarantors may be immediately enforced, without the necessity of an action against the principal obligor or collateral. First Com. Corp. v. Geter, 37 Colo. App. 391, 547 P.2d 1291 (1976).

The right of a secured party to a deficiency judgment is established, so that failure of secured party to give reasonable notice of sale does not result in a forfeiture of the right to recover a deficiency judgment. Cmty. Mgt. Ass'n of Colo. Springs, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973).

Failure to give notice of the disposition of the collateral does not preclude the creditor from recovering a deficiency if it can prove the amount thereof. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980); Zimmerman v. Cook, 651 P.2d 910 (Colo. App. 1982).

Director of revenue not involved in repossession and transfer of ownership. The activity of the director of revenue in the issuance of a new title to a repossessor of a motor vehicle is strictly limited to the ministerial duty of providing prima facie evidence of what has already occurred by purely private action, namely, the transfer of title from the debtor to the creditor in a manner specifically provided for by their agreement. It does not in any meaningful way involve the director in the repossession and subsequent transfer of ownership to the repossessor. Sifuentes v. Weed, 186 Colo. 109, 525 P.2d 1157 (1974).

Sufficient evidence that notice sent. The existence of a business custom is sufficient to warrant a presumption that notice was sent. It is then up to the court to decide if that presumption is overcome by other evidence. Greeley Nat. Bank v. Sloan, 677 P.2d 409 (Colo. App. 1983).

Amount received at sale as evidence of market value of collateral. If the sale of the collateral has been conducted in accordance

with the requirements of the UCC, the amount received at the sale will be competent evidence of the market value. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

Amount received at sale is not evidence of market value if sale is not conducted in compliance with law. Where, because of lack of notice, the sale is not conducted in compliance with the law, the amount received is not evidence of the market value, and the secured party has to prove value by other evidence. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

Debtor entitled to market value offset against balance due. The debtors are entitled to have the market value of the collateral at the time and place of sale offset against any balance due on the indebtedness. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

Evidence of purchaser's lack of good faith. Knowledge that the holder of a subordinate security interest had not been given the notice required by this section might be evidence of a want of good faith on the part of a purchaser. Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977).

"Debtor" construed. Accommodation comakers and those others who will be called upon to pay deficiencies are "debtors" within the meaning of § 4-9-105 (1)(d) and subsection (3) of this section, and are entitled to notice of the disposition of the collateral. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

Subsection (3) deals with both the collateral and the obligation and, accordingly, the term "debtor" includes both the owner of the collateral and the obligor when they are not the same person. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

"Debtor" includes a guarantor and, as a debtor, the guarantor may not waive debtor's right to insist on a commercially reasonable disposition of collateral. May v. Women's Bank, N.A., 807 P.2d 1145 (Colo. 1991).

A guarantor is treated as a debtor for purposes of article 9 of the Colorado Uniform Commercial Code. The protections afforded by subsection (3) that collateral be disposed of in a commercially reasonable manner are also provided to a guarantor. FBS AG Credit, Inc. v. Estate of Walker, 906 F. Supp. 1427 (D. Colo. 1995).

In proving "commercial reasonableness", the burden of proof is on the creditor. In re Wells, 51 Bankr. 563 (D. Colo. 1985).

Creditor's sale of property used as collateral to themselves is not commercially reasonable when there is expert testimony that there was no recognized market for the property and it was not subject to widely distributed standard price quotation. Cooper Investments v. Conger, 775 P.2d 76 (Colo. App. 1989).

The retention of collateral by a creditor for an excessive period of time without disposition may be commercially unreasonable in violation of this section. The question of reasonableness is one of fact for the trial court. Tajalli v. Gharibi, 758 P.2d 190 (Colo. App. 1988).

Presumption of no deficiency following repossession. There is a presumption that the value of the repossessed collateral is equal to the amount of the outstanding debt and that, therefore, there is no deficiency. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

This section provides that reasonable notification of sale must be made unless the collateral is either perishable, threatens to decline speedily in value, or is of a type customarily sold on a recognized market. Cmty. Mgt. Ass'n of Colo. Springs, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973).

Article 9 does not determine location of title after default. People ex rel. VanMeveren v. District Court, 619 P.2d 494 (Colo. 1980).

This section is made inoperative by § 4-9-501 with respect to water stock foreclosed as a part of real estate security. Kinoshita v. North Denver Bank, 181 Colo. 183, 508 P.2d 1264 (1973).

The purpose of the notice requirement in subsection (3) is to give all persons having interests in the collateral or facing possible deficiency claims an opportunity to protect their interests and to utilize all practicable means of reducing to eliminating their potential liability. Western Nat'l Bank v. VFW Post 8103, 660 P.2d 919 (Colo. App. 1983).

A post-default waiver by the defendant of the notice requirement of subsection (3) can be made only when the debtor knowingly and specifically agrees to waive right to such notice. Burdick v. Tucker, 780 P.2d 34 (Colo. App. 1989).

If a secured party fails to give proper notice under subsection (3), a presumption arises that the value of the collateral at the time of sale was equal to the amount of the outstanding debt, so that no deficiency results. Colo. Leasing Corp. v. Borquez, 738 P.2d 377 (Colo. 1986).

Notice required under subsection (3) may not be waived. United Bank v. Reed, 635 P.2d 922 (Colo. App. 1981).

Fulfillment of notice requirement for private sale. In the case of a private sale, the statutory notice requirement is fulfilled when the creditor sends reasonable notification stating the date after which the collateral will be sold. Western Nat'l Bank v. VFW Post 8103, 660 P.2d 919 (Colo. App. 1983).

Under plain language of this section, sale of wraparound promissory note transferred all debtor's rights to purchaser at foreclosure sale and discharged creditor's security interest therein; accordingly, purchaser took free of restrictions contained in security agreement. West-

ern Group Nurseries v. Pomeranz, 867 P.2d 12 (Colo. App. 1993).

Failure of creditor to comply with the notice requirements of this section did not prevent new buyer from taking all of the debtor's rights in the repossessed car even though the certificate of title had not been transferred to the buyer prior to the automatic stay provided for by 11 U.S.C. § 362. In re Duffy, 186 Bankr. 503 (Bankr. D. Colo. 1995).

Section 4-9-105 (1)(d) does not require "debtor" to be owner or have rights in the collateral. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

Applied in Western Nat'l Bank v. ABC Drilling Co., 42 Colo. App. 407, 599 P.2d 942 (1979); First Nat'l Bank v. District Court, 653 P.2d 1123 (Colo. 1982).

4-9-611. Notification before disposition of collateral. (a) In this section, "notification date" means the earlier of the date on which:

(1) A secured party sends to the debtor and any secondary obligor an authenticated notification of disposition; or

(2) The debtor and any secondary obligor waive the right to notification as provided in section 4-9-624 (a).

(b) Except as otherwise provided in subsection (d) of this section, a secured party that disposes of collateral under section 4-9-610 shall send to the persons specified in subsection (c) of this section a reasonable authenticated notification of disposition.

(c) To comply with subsection (b) of this section, the secured party shall send an authenticated notification of disposition to:

(1) The debtor;

(2) Any secondary obligor; and

(3) If the collateral is other than consumer goods:

(A) Any other person from which the secured party has received, before the notification date, an authenticated notification of a claim of an interest in the collateral;

(B) Any other secured party or lienholder that, ten days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

(i) Identified the collateral;

(ii) Was indexed under the debtor's name as of that date; and

(iii) Was filed in the office in which to file a financing statement against the debtor covering the collateral as of that date; and

(C) Any other secured party that, ten days before the notification date, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in section 4-9-311 (a).

(d) Subsection (b) of this section does not apply if the collateral is perishable or the creditor in good faith believes that the collateral threatens to decline speedily in value or is of a type customarily sold on a recognized market. The specific reference to good faith in this subsection (d) does not abrogate the general obligation of the secured party to proceed in a commercially reasonable manner.

(e) A secured party complies with the requirement for notification prescribed by subparagraph (B) of paragraph (3) of subsection (c) of this section if:

(1) Not later than twenty days or earlier than thirty days before the notification date, the secured party requests, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the office indicated in subparagraph (B) of paragraph (3) of subsection (c) of this section; and

(2) Before the notification date, the secured party:

(A) Did not receive a response to the request for information; or

(B) Received a response to the request for information and sent an authenticated notification of disposition to each secured party or other lienholder named in that response whose financing statement covered the collateral.

Source: L. 2001: Entire article R&RE, p. 1404, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-504 (3) as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado added the phrase "as provided in section 4-9-624 (a)" to subsection (a)(2) and added the references to good faith in subsection (d).

OFFICIAL COMMENT

1. **Source.** Former Section 9-504(3).

2. **Reasonable Notification.** This section requires a secured party who wishes to dispose of collateral under Section 9-610 to send "a reasonable authenticated notification of disposition" to specified interested persons, subject to certain exceptions. The notification must be reasonable as to the manner in which it is sent, its timeliness (i.e., a reasonable time before the disposition is to take place), and its content. See Sections 9-612 (timeliness of notification), 9-613 (contents of notification generally), 9-614 (contents of notification in consumer-goods transactions).

3. **Notification to Debtors and Secondary Obligors.** This section imposes a duty to send notification of a disposition not only to the debtor but also to any secondary obligor. Subsections (b) and (c) resolve an uncertainty under former Article 9 by providing that secondary obligors (sureties) are entitled to receive notification of an intended disposition of collateral, regardless of who created the security interest in the collateral. If the surety created the security interest, it would be the debtor. If it did not, it would be a secondary obligor. (This Article also resolves the question of the secondary obligor's ability to waive, pre-default, the right to notification waiver generally is not permitted. See Section 9-602.) Section 9-605 relieves a secured party from any duty to send notification to a debtor or secondary obligor unknown to the secured party.

Under subsection (b), the principal obligor (borrower) is not always entitled to notification of disposition.

Example: Behnfeldt borrows on an unsecured basis, and Bruno grants a security interest in her car to secure the debt. Behnfeldt is a primary obligor, not a secondary obligor. As such, she is not entitled to notification of disposition under this section.

4. **Notification to Other Secured Parties.** Prior to the 1972 amendments to Article 9, former Section 9-504(3) required the enforcing secured party to send reasonable notification of the disposition: except in the case of consumer goods to any other person who has a security interest in the collateral and who has duly filed a financing statement indexed in the name of the debtor in this State or who is known by the secured party to have a security interest in the collateral.

The 1972 amendments eliminated the duty to give notice to secured parties other than those from whom the foreclosing secured party had received written notice of a claim of an interest in the collateral.

Many of the problems arising from dispositions of collateral encumbered by multiple security interests can be ameliorated or solved by informing all secured parties of an intended disposition and affording them the opportunity to work with one another. To this end, subsection (c)(3)(B) expands the duties of the foreclosing secured party to include the duty to notify (and the corresponding burden of searching the files to discover) certain competing secured parties. The subsection imposes a search burden that in some cases may be greater than the pre-1972 burden on foreclosing secured parties but certainly is more modest than that faced by a new secured lender.

To determine who is entitled to notification, the foreclosing secured party must determine the proper office for filing a financing statement as of a particular date, measured by reference to the "notification date," as defined in subsection (a). This determination requires reference to the choice-of-law provisions of Part 3. The secured party must ascertain whether any financing statements covering the collateral and indexed under the debtor's name, as the name existed as of that date, in fact were filed in that office. The foreclosing secured party generally need not notify secured parties whose effective financing statements have become more difficult to locate because of changes in the location of the debtor, proceeds rules, or changes in the debtor's name [that is sufficient as the name of the debtor under Section 9-503(a).]

Note: "Debtor's" in the last sentence will be deleted and the bracketed language takes effect July 1, 2013.

Under subsection (c)(3)(C), the secured party also must notify a secured party who has perfected a security interest by complying with a statute or treaty described in Section 9-311(a), such as a certificate-of-title statute.

Subsection (e) provides a "safe harbor" that takes into account the delays that may be attendant to receiving information from the public filing offices. It provides, generally, that the secured party will be deemed to have satisfied its notification duty under subsection (c)(3)(B) if it requests a search from the proper office at least 20 but not more than 30 days before sending notification to the debtor and if it also sends a notification to all secured parties (and other lienholders) reflected on the search report. The secured party's duty under subsection (c)(3)(B) also will be satisfied if the secured party requests but does not receive a search report before the notification is sent to the debtor. Thus, if subsection (e) applies, a secured party who is

entitled to notification under subsection (c)(3)(B) has no remedy against a foreclosing secured party who does not send the notification. The foreclosing secured party has complied with the notification requirement. Subsection (e) has no effect on the requirements of the other paragraphs of subsection (c). For example, if the foreclosing secured party received a notification from the holder of a conflicting security interest in accordance with subsection (c)(3)(A) but failed to send to the holder a notification of the disposition, the holder of the conflicting security interest would have the right to recover any loss under Section 9-625(b).

5. **Authentication Requirement.** Subsections (b) and (c) explicitly provide that a notification of disposition must be "authenticated." Some cases read former Section 9-504(3) as validating oral notification.

6. **Second Try.** This Article leaves to judicial resolution, based upon the facts of each case, the question whether the requirement of "reasonable notification" requires a "second try," i.e., whether a secured party who sends notification and learns that the debtor did not receive it must attempt to locate the debtor and send another notification.

7. **Recognized Market; Perishable Collateral.** New subsection (d) makes it clear that there is no obligation to give notification of a disposition in the case of perishable collateral or collateral customarily sold on a recognized market (e.g., marketable securities). Former Section 9-504(3) might be read (incorrectly) to relieve the secured party from its duty to notify a debtor but not from its duty to notify other secured parties in connection with dispositions of such collateral.

8. **Failure to Conduct Notified Disposition.** Nothing in this Article prevents a secured party from electing not to conduct a disposition after sending a notification. Nor does this Article prevent a secured party from electing to send a revised notification if its plans for disposition change. This assumes, however, that the secured party acts in good faith, the revised notification is reasonable, and the revised plan for disposition and any attendant delay are commercially reasonable.

9. **Waiver.** A debtor or secondary obligor may waive the right to notification under this section only by a post-default authenticated agreement. See Section 9-624(a).

[10. **Other Law.** Other State or federal law may contain requirements concerning notification of a disposition of property by a secured party. For example, federal law imposes notification requirements with respect to the enforcement of mortgages on federally documented vessels. Principles of statutory interpretation and, in the context of federal law, supremacy and preemption determine whether and to what extent law other than this Article supplements, displaces, or is displaced by this Article. See Sections 1-103, 1-104, 9-109(c)(1).]

Note: The bracketed language takes effect July 1, 2013.

ANNOTATION

Law reviews. For comment, "Remedies for Failure to Notify Debtor of Disposition of Repossessed Collateral Under the U.C.C.", see 44 U. Colo. L. Rev. 221 (1972). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Commercial Law", see 55 Den. L.J. 425 (1978). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983). For article, "A Review of Agricultural Law: Hard Times and Hard Choices", see 15 Colo. Law. 629 (1986). For article, "The Colorado Farm Homestead Protection Act", see 15 Colo. Law. 1642 (1986). For article, "Agricultural Lending in a Troubled Economy", see 16 Colo. Law. 1773 (1987). For article, "The Agricultural Credit Act of 1987", see 17 Colo. Law. 611 (1988).

Annotator's note. Section 4-9-611 is similar to § 4-9-504 as it existed prior to the 2001 repeal and reenactment of this article. Relevant cases construing § 4-9-504 have been included in the annotations to § 4-9-610.

4-9-612. Timeliness of notification before disposition of collateral. (a) Except as otherwise provided in subsection (b) of this section, whether a notification is sent within a reasonable time is a question of fact.

(b) In a transaction other than a consumer transaction, a notification of disposition sent after default and ten days or more before the earliest time of disposition set forth in the notification is sent within a reasonable time before the disposition.

Source: L. 2001: Entire article R&RE, p. 1405, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Reasonable Notification.** Section 9-611(b) requires the secured party to send a "reasonable authenticated notification." Under that section, as under former Section 9-504(3), one aspect of a reasonable notification is its timeliness. This generally means that the notification must be sent at a reasonable time in advance of the date of a public disposition or the date after which a private disposition is to be made. A notification that is sent so near to the disposition date that a notified person could not be expected to act on or take account of the notification would be unreasonable.

3. **Timeliness of Notification: Safe Harbor.** The 10-day notice period in subsection (b) is intended to be a "safe harbor" and not a minimum requirement. To qualify for the "safe harbor" the notification must be sent after default. A notification also must be sent in a commercially reasonable manner. See Section 9-611(b) ("reasonable authenticated notification"). These requirements prevent a secured party from taking advantage of the "safe harbor" by, for example, giving the debtor a notification at the time of the original extension of credit or sending the notice by surface mail to a debtor overseas.

4-9-613. Contents and form of notification before disposition of collateral: general.

(a) Except in a consumer-goods transaction, the following rules apply:

(1) The contents of a notification of disposition are sufficient if the notification:

(A) Describes the debtor and the secured party;

(B) Describes the collateral that is the subject of the intended disposition;

(C) States the method of intended disposition;

(D) States that the debtor is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for an accounting; and

(E) States the time and place of a public disposition or the time after which any other disposition is to be made.

(2) Whether the contents of a notification that lacks any of the information specified in paragraph (1) of this subsection (a) are nevertheless sufficient is a question of fact.

(3) The contents of a notification providing substantially the information specified in paragraph (1) of this subsection (a) are sufficient, even if the notification includes:

(A) Information not specified by said paragraph (1); or

(B) Minor errors that do not cause damages to a person who relies on the information.

(4) A particular phrasing of the notification is not required.

(5) The following form of notification and the form appearing in section 4-9-614 (3), when completed, each provides sufficient information:

NOTIFICATION OF DISPOSITION OF COLLATERAL

To: [*Name of debtor, obligor, or other person to which the notification is sent*]

From: [*Name, address, and telephone number of secured party*]

Name of Debtor(s): [*Include only if debtor(s) are not an addressee*]

[*For a public disposition:*]

We will sell [or lease or license, *as applicable*] the [*describe collateral*] [to the highest qualified bidder] in public as follows:

Day and Date: ____________________
Time: ____________________
Place: ____________________

[*For a private disposition:*]

We will sell [or lease or license, *as applicable*] the [*describe collateral*] privately sometime after [*day and date*].

You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell [or lease or license, *as applicable*] [for a charge of $__________]. You may request an accounting by calling us at [*telephone number*] or writing us at [*address*].

Source: L. 2001: Entire article R&RE, p. 1406, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado substituted the word "disposition" for the word "sale" in subsection (a)(1)(E) and substituted the phrase "cause damages to a person who relies on the information" for the phrase "seriously misleading" in subsection (a)(3)(B). Colorado added the phrase "or writing us at [*address*]" at the end of the notification form contained in subsection (a)(5).

OFFICIAL COMMENT

1. **Source.** New.

2. **Contents of Notification.** To comply with the "reasonable authenticated notification" requirement of Section 9-611(b), the contents of a notification must be reasonable. Except in a consumer-goods transaction, the contents of a notification that includes the information set forth in paragraph (1) are sufficient as a matter of law, unless the parties agree otherwise. (The reference to "time" of disposition means here, as it did in former Section 9-504(3), not only the hour of the day but also the date.) Although a secured party may choose to include additional information concerning the transaction or the debtor's rights and obligations, no additional information is required unless the parties agree otherwise. A notification that lacks some of the information set forth in paragraph (1) nevertheless may be sufficient if found to be reasonable by the trier of fact, under paragraph (2). A properly completed sample form of notification in paragraph (5) or in Section 9-614(a)(3) is an example of a notification that would contain the information set forth in paragraph (1). Under paragraph (4), however, no particular phrasing of the notification is required.

[This section applies to a notification of a public disposition conducted electronically. A notification of an electronic disposition satisfies paragraph (1)(E) if it states the time when the disposition is scheduled to begin and states the electronic location. For example, under the technology current in 2010, the Uniform Resource Locator (URL) or other Internet address where the site of the public disposition can be accessed suffices as an electronic location.]

Note: The bracketed language takes effect July 1, 2013.

4-9-614. Contents and form of notification before disposition of collateral: consumer-goods transaction. (a) In a consumer-goods transaction, the following rules apply:

(1) A notification of disposition must provide the following information:

(A) The information specified in section 4-9-613 (1);

(B) A description of any liability for a deficiency of the person to which the notification is sent;

(C) A telephone number and mailing address from which the amount that must be paid to the secured party to redeem the collateral under section 4-9-623 is available; and

(D) A telephone number and mailing address from which additional information concerning the disposition and the obligation secured is available.

(2) A particular phrasing of the notification is not required.

(3) The following form of notification, when completed, provides sufficient information:

[*Name and address of secured party*]

[*Date*]

NOTICE OF OUR PLAN TO SELL PROPERTY

[*Name and address of any obligor who is also a debtor*]

Subject:

[*Identification of Transaction*]

We have your [*describe collateral*], because you broke promises in our agreement.

[*For a public disposition:*]

We will sell [*describe collateral*] at public sale. A sale could include a lease or license. The sale will be held as follows:

Date: ____________________
Time: ____________________
Place: ____________________

You may attend the sale and bring bidders if you want.

[*For a private disposition:*]

We will sell [*describe collateral*] at private sale sometime after [*date*]. A sale could include a lease or license.

The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you [*will or will not, as applicable*] still owe us the difference. If we get more money than you owe, you will get the extra money, unless we must pay it to someone else.

You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at [*telephone number*] or write us at [*secured party's address*].

If you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at [*telephone number*] [or write us at [*secured party's address*]] and request a written explanation. [We will charge you $__________ for the explanation if we have already sent you an explanation of the type requested within the last six months.]

If you need more information about the sale call us at [*telephone number*] [or write us at [*secured party's address*]].

We are sending this notice to the following other people who have an interest in [*describe collateral*] or who owe money under your agreement:

[*Names of all other debtors and obligors, if any*]

(4) A notification in the form of paragraph (3) of this subsection (a) is sufficient, even if additional information appears at the end of the form.

(5) A notification in the form of paragraph (3) of this subsection (a) is sufficient, even if it includes errors in information not required by paragraph (1) of this subsection (a), unless the error is misleading with respect to rights arising under this article.

(6) If a notification under this section is not in the form of paragraph (3) of this subsection (a), law other than this article determines the effect of including information not required by paragraph (1) of this section.

Source: L. 2001: Entire article R&RE, p. 1407, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado added the phrase "and mailing address" in subsection (a)(1)(C) and substituted "and" for "or" in subsection (a)(1)(D). Colorado added the phrase "or write us at [*secured party's address*]" in the form regarding how to learn the exact amount the debtor must pay. The uniform act's form regarding explanations reads: "We will charge you $ ________ for the explanation if we sent you another written explanation of the amount you owe us within the last six months."

OFFICIAL COMMENT

1. **Source.** New.

2. **Notification in Consumer-Goods Transactions.** Paragraph (1) sets forth the information required for a reasonable notification in a consumer-goods transaction. A notification that lacks any of the information set forth in paragraph (1) is insufficient as a matter of law. Compare Section 9-613(2), under which the trier of fact may find a notification to be sufficient even if it lacks some information listed in paragraph (1) of that section.

3. **Safe-Harbor Form of Notification; Errors in Information.** Although paragraph (2) provides that a particular phrasing of a notification is not required, paragraph (3) specifies a safe-harbor form that, when properly completed, satisfies paragraph (1). Paragraphs (4), (5), and (6) contain special rules applicable to erroneous

and additional information. Under paragraph (4), a notification in the safe-harbor form specified in paragraph (3) is not rendered insufficient if it contains additional information at the end of the form. Paragraph (5) provides that non-misleading errors in information contained in a notification are permitted if the safe-harbor form is used *and if the errors are in information not required by paragraph (1)*. Finally, if a notification is in a form other than the paragraph (3) safe-harbor form, other law determines the effect of including in the notification information other than that required by paragraph (1).

4-9-615. Application of proceeds of disposition; liability for deficiency and right to surplus. (a) A secured party shall apply or pay over for application the cash proceeds of disposition under section 4-9-610 in the following order to:

(1) The reasonable expenses of retaking, holding, preparing for disposition, processing, and disposing, and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and reasonable legal expenses incurred by the secured party;

(2) The satisfaction of obligations secured by the security interest or agricultural lien under which the disposition is made;

(3) The satisfaction of obligations secured by any subordinate security interest in or other subordinate lien on the collateral if:

(A) The secured party receives from the holder of the subordinate security interest or other lien an authenticated demand for proceeds before distribution of the proceeds is completed; and

(B) In a case in which a consignor has an interest in the collateral, the subordinate security interest or other lien is senior to the interest of the consignor; and

(4) A secured party that is a consignor of the collateral if the secured party receives from the consignor an authenticated demand for proceeds before distribution of the proceeds is completed.

(b) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder does so, the secured party need not comply with the holder's demand under paragraph (3) of subsection (a) of this section.

(c) A secured party need not apply or pay over for application noncash proceeds of disposition under section 4-9-610 unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(d) If the security interest under which a disposition is made secures payment or performance of an obligation, after making the payments and applications required by subsection (a) of this section and permitted by subsection (c) of this section:

(1) Unless paragraph (4) of subsection (a) of this section requires the secured party to apply or pay over cash proceeds to a consignor, the secured party shall account to and pay a debtor for any surplus; and

(2) The obligor is liable for any deficiency.

(e) If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes:

(1) The debtor is not entitled to any surplus; and

(2) The obligor is not liable for any deficiency.

(f) The surplus or deficiency following a disposition is calculated based on the amount of proceeds that would have been realized in a disposition complying with this part 6 to a transferee other than the secured party, a person related to the secured party, or a secondary obligor if:

(1) The transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor; and

(2) The amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(g) A secured party that receives cash proceeds of a disposition in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or

other lien that is not subordinate to the security interest or agricultural lien under which the disposition is made:

(1) Takes the cash proceeds free of the security interest or other lien;

(2) Is not obligated to apply the proceeds of the disposition to the satisfaction of obligations secured by the security interest or other lien; and

(3) Is not obligated to account to or pay the holder of the security interest or other lien for any surplus.

Source: L. 2001: Entire article R&RE, p. 1409, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-504 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado added the phrase "under section 4-9-610" in the introductory portion to subsection (a), added the word "reasonable" before the word "legal" in subsection (a)(1), and substituted the phrase "section 4-9-610" for "this section" in subsection (c).

OFFICIAL COMMENT

1. **Source.** Former Section 9-504(1), (2).

2. **Application of Proceeds.** This section contains the rules governing application of proceeds and the debtor's liability for a deficiency following a disposition of collateral. Subsection (a) sets forth the basic order of application. The proceeds are applied first to the expenses of disposition, second to the obligation secured by the security interest that is being enforced, and third, in the specified circumstances, to interests that are subordinate to that security interest.

Subsections (a) and (d) also address the right of a consignor to receive proceeds of a disposition by a secured party whose interest is senior to that of the consignor. Subsection (a) requires the enforcing secured party to pay excess proceeds first to subordinate secured parties or lienholders whose interests are senior to that of a consignor and, finally, to a consignor. Inasmuch as a consignor is the owner of the collateral, secured parties and lienholders whose interests are junior to the consignor's interest will not be entitled to any proceeds. In like fashion, under subsection (d)(1) the debtor is not entitled to a surplus when the enforcing secured party is required to pay over proceeds to a consignor.

3. **Noncash Proceeds.** Subsection (c) addresses the application of noncash proceeds of a disposition, such as a note or lease. The explanation in Section 9-608, Comment 4, generally applies to this subsection.

Example: A secured party in the business of selling or financing automobiles takes possession of collateral (an automobile) following its debtor's default. The secured party decides to sell the automobile in a private disposition under Section 9-610 and sends appropriate notification under Section 9-611. After undertaking its normal credit investigation and in accordance with its normal credit policies, the secured party sells the automobile on credit, on terms typical of the credit terms normally extended by the secured party in the ordinary course of its business. The automobile stands as collateral for the remaining balance of the price. The noncash proceeds received by the secured party are chattel paper. The secured party may wish to credit its debtor (the assignor) with the principal amount of the chattel paper or may wish to credit the debtor only as and when the payments are made on the chattel paper by the buyer.

Under subsection (c), the secured party is under no duty to apply the noncash proceeds (here, the chattel paper) or their value to the secured obligation unless its failure to do so would be commercially unreasonable. If a secured party elects to apply the chattel paper to the outstanding obligation, however, it must do so in a commercially reasonable manner. The facts in the example indicate that it would be commercially unreasonable for the secured party to fail to apply the value of the chattel paper to the original debtor's secured obligation. Unlike the example in Comment 4 to Section 9-608, the noncash proceeds received in this example are of the type that the secured party regularly generates in the ordinary course of its financing business in nonforeclosure transactions. The original debtor should not be exposed to delay or uncertainty in this situation. Of course, there will be many situations that fall between the examples presented in the Comment to Section 9-608 and in this Comment. This Article leaves their resolution to the court based on the facts of each case.

One would expect that where noncash proceeds are or may be material, the secured party and debtor would agree to more specific standards in an agreement entered into before or after default. The parties may agree to the method of application of noncash proceeds if the method is not manifestly unreasonable. See Section 9-603.

When the secured party is not required to "apply or pay over for application noncash proceeds," the proceeds nonetheless remain collateral subject to this Article. See Section 9-608, Comment 4.

4. **Surplus and Deficiency.** Subsection (d) deals with surplus and deficiency. It revises former Section 9-504(2) by imposing an explicit requirement that the secured party "pay" the debtor for any surplus, while retaining the secured party's duty to "account." Inasmuch as the debtor may not be an obligor, subsection (d) provides that the obligor (not the debtor) is liable for the deficiency. The special rule governing surplus and deficiency when receivables have been sold likewise takes into account the distinction between a debtor and an obligor. Subsection (d) also addresses the situation in which a consignor has an interest that is subordinate to the security interest being enforced.

5. **Collateral Under New Ownership.** When the debtor sells collateral subject to a security interest, the original debtor (creator of the security interest) is no longer a debtor inasmuch as it no longer has a property interest in the collateral; the buyer is the debtor. See Section 9-102. As between the debtor (buyer of the collateral) and the original debtor (seller of the collateral), the debtor (buyer) normally would be entitled to the surplus following a disposition. Subsection (d) therefore requires the secured party to pay the surplus to the debtor (buyer), not to the original debtor (seller) with which it has dealt. But, because this situation typically arises as a result of the debtor's wrongful act, this Article does not expose the secured party to the risk of determining ownership of the collateral. If the secured party does not know about the buyer and accordingly pays the surplus to the original debtor, the exculpatory provisions of this Article exonerate the secured party from liability to the buyer. See Sections 9-605, 9-628(a), (b). If a debtor sells collateral *free* of a security interest, as in a sale to a buyer in ordinary course of business (see Section 9-320(a)), the property is no longer collateral and the buyer is not a debtor.

6. **Certain "Low-Price" Dispositions.** Subsection (f) provides a special method for calculating a deficiency or surplus when the secured party, a person related to the secured party (defined in Section 9-102), or a secondary obligor acquires the collateral at a foreclosure disposition. It recognizes that when the foreclosing secured party or a related party is the transferee of the collateral, the secured party sometimes lacks the incentive to maximize the proceeds of disposition. As a consequence, the disposition may comply with the procedural requirements of this Article (e.g., it is conducted in a commercially reasonable manner following reasonable notice) but nevertheless fetch a low price.

Subsection (f) adjusts for this lack of incentive. If the proceeds of a disposition of collateral to a secured party, a person related to the secured party, or a secondary obligor are "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought," then instead of calculating a deficiency (or surplus) based on the actual net proceeds, the calculation is based upon the amount that would have been received in a commercially reasonable disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor. Subsection (f) thus rejects the view that the secured party's receipt of such a price necessarily constitutes noncompliance with Part 6. However, such a price may suggest the need for greater judicial scrutiny. See Section 9-610, Comment 10.

7. **"Person Related To."** Section 9-102 defines "person related to." That term is a key element of the system provided in subsection (f) for low-price dispositions. One part of the definition applies when the secured party is an individual, and the other applies when the secured party is an organization. The definition is patterned closely on the corresponding definition in Section 1.301(32) of the Uniform Consumer Credit Code.

ANNOTATION

Law reviews. For comment, "Remedies for Failure to Notify Debtor of Disposition of Repossessed Collateral Under the U.C.C.", see 44 U. Colo. L. Rev. 221 (1972). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Commercial Law", see 55 Den. L.J. 425 (1978). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983). For article, "A Review of Agricultural Law: Hard Times and Hard Choices", see 15 Colo. Law. 629 (1986). For article, "The Colorado Farm Homestead Protection Act", see 15 Colo. Law. 1642 (1986). For article, "Agricultural Lending in a Troubled Economy", see 16 Colo. Law. 1773 (1987). For article, "The Agricultural Credit Act of 1987", see 17 Colo. Law. 611 (1988).

Annotator's note. Since § 4-9-615 is similar to § 4-9-504 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

"Disposition" of collateral connotes receipt of "proceeds". Where collateral was released to the debtor, and the creditor did not receive "pro-

ceeds", no "disposition" of the collateral took place. Silverberg v. Colantuno, 991 P.2d 280 (Colo. App. 1998).

The right of a secured party to a deficiency judgment is established, so that failure of secured party to give reasonable notice of sale does not result in a forfeiture of the right to recover a deficiency judgment. Cmty. Mgt. Ass'n of Colo. Springs, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973).

Failure to give notice of the disposition of the collateral does not preclude the creditor from recovering a deficiency if it can prove the amount thereof. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980); Zimmerman v. Cook, 651 P.2d 910 (Colo. App. 1982).

Debtor entitled to market value offset against balance due. The debtors are entitled to have the market value of the collateral at the time and place of sale offset against any balance due on the indebtedness. First Nat'l Bank v. Cillessen, 622 P.2d 598 (Colo. App. 1980).

4-9-616. Explanation of calculation of surplus or deficiency - definitions. (a) In this section:

(1) "Explanation" means a writing that:

(A) States the amount of the surplus or deficiency;

(B) Provides an explanation in accordance with subsection (c) of this section of how the secured party calculated the surplus or deficiency;

(C) States, if applicable, that future debits, credits, charges, including additional credit service charges or interest, rebates, and expenses may affect the amount of the surplus or deficiency; and

(D) Provides a telephone number and mailing address from which additional information concerning the transaction is available.

(2) "Request" means a record:

(A) Authenticated by a debtor or consumer obligor;

(B) Requesting that the recipient provide an explanation; and

(C) Sent after disposition of the collateral under section 4-9-610.

(b) In a consumer-goods transaction in which the debtor is entitled to a surplus or a consumer obligor is liable for a deficiency under section 4-9-615, the secured party shall:

(1) Send an explanation to the debtor or consumer obligor, as applicable, after the disposition and:

(A) Before or when the secured party accounts to the debtor and pays any surplus or first makes written demand on the consumer obligor after the disposition for payment of the deficiency; and

(B) Within fourteen days after receipt of a request; or

(2) In the case of a consumer obligor who is liable for a deficiency, within fourteen days after receipt of a request, send to the consumer obligor a record waiving the secured party's right to a deficiency.

(c) To comply with subparagraph (B) of paragraph (1) of subsection (a) of this section, a writing must provide the following information in the following order:

(1) The aggregate amount of obligations secured by the security interest under which the disposition was made, and, if the amount reflects a rebate of unearned interest or credit service charge, an indication of that fact, calculated as of a specified date:

(A) If the secured party takes or receives possession of the collateral after default, not more than thirty-five days before the secured party takes or receives possession; or

(B) If the secured party takes or receives possession of the collateral before default or does not take possession of the collateral, not more than thirty-five days before the disposition;

(2) The amount of proceeds of the disposition;

(3) The aggregate amount of the obligations after deducting the amount of proceeds;

(4) The amount, in the aggregate or by type, and types of expenses, including reasonable expenses of retaking, holding, preparing for disposition, processing, and disposing of the collateral, and reasonable attorney's fees secured by the collateral which are known to the secured party and relate to the current disposition;

(5) The amount, in the aggregate or by type, and types of credits, including rebates of interest or credit service charges, to which the obligor is known to be entitled and which are not reflected in the amount in paragraph (1) of this subsection (c); and

(6) The amount of the surplus or deficiency.

(d) A particular phrasing of the explanation is not required. An explanation complying substantially with the requirements of subsection (a) of this section is sufficient, even if it includes minor errors that do not cause damages to a person who relies on the information.

(e) A debtor or consumer obligor is entitled without charge to three responses to a request under this section during any six-month period in which the secured party did not send to the debtor or consumer obligor an explanation pursuant to paragraph (1) of subsection (b) of this section. The secured party may require payment of a charge, not exceeding fifteen dollars, for each additional response.

Source: L. 2001: Entire article R&RE, p. 1410, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado substituted the word "and" for "or" in subsection (a)(1)(D), twice added the word "reasonable" to subsection (c)(4), substituted the phrase "do not cause damages to a person who relies on the information" for the phrase "are not seriously misleading" in subsection (d), and substituted the phrase "three responses" for "one response" and reduced the charge from $25 to $15 in subsection (e).

OFFICIAL COMMENT

1. **Source.** New.

2. **Duty to Send Information Concerning Surplus or Deficiency.** This section reflects the view that, in every consumer-goods transaction, the debtor or obligor is entitled to know the amount of a surplus or deficiency and the basis upon which the surplus or deficiency was calculated. Under subsection (b)(1), a secured party is obligated to provide this information (an "explanation," defined in subsection (a)(1)) no later than the time that it accounts for and pays a surplus or the time of its first written attempt to collect the deficiency. The obligor need not make a request for an accounting in order to receive an explanation. A secured party who does not attempt to collect a deficiency in writing or account for and pay a surplus has no obligation to send an explanation under subsection (b)(1) and, consequently, cannot be liable for noncompliance.

A debtor or secondary obligor need not wait until the secured party commences written collection efforts in order to receive an explanation of how a deficiency or surplus was calculated. Subsection (b)(2) obliges the secured party to send an explanation within 14 days after it receives a "request" (defined in subsection (a)(2)).

Note: The reference to "Subsection (b)(2)" in the second sentence will be replaced with "Subsection (b)(1)(B)", effective July 1, 2013.

3. **Explanation of Calculation of Surplus or Deficiency.** Subsection (c) contains the requirements for how a calculation of a surplus or deficiency must be explained in order to satisfy subsection (a)(1)(B). It gives a secured party some discretion concerning rebates of interest or credit service charges. The secured party may include these rebates in the aggregate amount of obligations secured, under subsection (c)(1), or may include them with other types of rebates and credits under subsection (c)(5). Rebates of interest or credit service charges are the only types of rebates for which this discretion is provided. If the secured party provides an explanation that includes rebates of pre-computed interest, its explanation must so indicate. The expenses and attorney's fees to be described pursuant to subsection (c)(4) are those relating to the most recent disposition, not those that may have been incurred in connection with earlier enforcement efforts and which have been resolved by the parties.

4. **Liability for Noncompliance.** A secured party who fails to comply with subsection (b)(2) is liable for any loss caused plus $500. See Section 9-625(b), (c), (e)(6). A secured party who fails to send an explanation under subsection (b)(1) is liable for any loss caused plus, if the noncompliance was "part of a pattern, or consistent with a practice of noncompliance," $500. See Section 9-625(b), (c), (e)(5). However, a secured party who fails to comply with this section is not liable for statutory minimum damages under Section 9-625(c)(2). See Section 9-628(d).

4-9-617. Rights of transferee of collateral. (a) A secured party's disposition of collateral after default:

(1) Transfers to a transferee for value all of the debtor's rights in the collateral;

(2) Discharges the security interest under which the disposition is made; and

(3) Discharges any subordinate security interest or other subordinate lien.

(b) A transferee that acts in good faith takes free of the rights and interests described

in subsection (a) of this section, even if the secured party fails to comply with this article or the requirements of any judicial proceeding.

(c) If a transferee does not take free of the rights and interests described in subsection (a) of this section, the transferee takes the collateral subject to:

(1) The debtor's rights in the collateral;

(2) The security interest or agricultural lien under which the disposition is made; and

(3) Any other security interest or other lien.

Source: L. 2001: Entire article R&RE, p. 1412, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-504 (4) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-504(4).

2. **Title Taken by Good-Faith Transferee.** Subsection (a) sets forth the rights acquired by persons who qualify under subsection (b) transferees who act in good faith. Such a person is a "transferee," inasmuch as a buyer at a foreclosure sale does not meet the definition of "purchaser" in Section 1-201 (the transfer is not, vis-a-vis the debtor, "voluntary"). By virtue of the expanded definition of the term "debtor" in Section 9-102, subsection (a) makes clear that the ownership interest of a person who bought the collateral subject to the security interest is terminated by a subsequent disposition under this Part. Such a person is a debtor under this Article. Under former Article 9, the result arguably was the same, but the statute was less clear. Under subsection (a), a disposition normally discharges the security interest being foreclosed and any subordinate security interests and other liens.

A disposition has the effect specified in subsection (a), even if the secured party fails to comply with this Article. An aggrieved person (e.g., the holder of a subordinate security interest to whom a notification required by Section 9-611 was not sent) has a right to recover any loss under Section 9-625(b).

3. **Unitary Standard in Public and Private Dispositions.** Subsection (b) now contains a unitary standard that applies to transferees in both private and public dispositions—acting in good faith. However, this change from former Section 9-504(4) should not be interpreted to mean that a transferee acts in good faith even though it has knowledge of defects or buys in collusion, standards applicable to public dispositions under the former section. Properly understood, those standards were specific examples of the absence of good faith.

4. **Title Taken by Nonqualifying Transferee.** Subsection (c) specifies the consequences for a transferee who does not qualify for protection under subsections (a) and (b) (i.e., a transferee who does not act in good faith). The transferee takes subject to the rights of the debtor, the enforcing secured party, and other security interests or other liens.

ANNOTATION

Annotator's note. Since § 4-9-617 is similar to § 4-9-504 as it existed prior to the 2001 repeal and reenactment of this article, a relevant case construing that provision has been included in the annotations to this section.

Under plain language of this section, sale of wraparound promissory note transferred all debtor's rights to purchaser at foreclosure sale and discharged creditor's security interest therein; accordingly, purchaser took free of restrictions contained in security agreement. Western Group Nurseries v. Pomeranz, 867 P.2d 12 (Colo. App. 1993).

4-9-618. Rights and duties of certain secondary obligors. (a) A secondary obligor acquires the rights and becomes obligated to perform the duties of the secured party after the secondary obligor:

(1) Receives an assignment of a secured obligation from the secured party;

(2) Receives a transfer of collateral from the secured party and agrees to accept the rights and assume the duties of the secured party; or

(3) Is subrogated to the rights of a secured party with respect to collateral.

(b) An assignment, transfer, or subrogation described in subsection (a) of this section:

(1) Is not a disposition of collateral under section 4-9-610; and

(2) Relieves the secured party of further duties under this article.

Source: L. 2001: Entire article R&RE, p. 1413, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-504 (5) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-504(5).

2. **Scope of This Section.** Under this section, assignments of secured obligations and other transactions (regardless of form) that function like assignments of secured obligations are not dispositions to which Part 6 applies. Rather, they constitute assignments of rights and (occasionally) delegations of duties. Application of this section may require an investigation into the agreement of the parties, which may not be reflected in the words of the repurchase agreement (e.g., when the agreement requires a recourse party to "purchase the collateral" but contemplates that the purchaser will then conduct an Article 9 foreclosure disposition).

This section, like former Section 9-504(5), does not constitute a general and comprehensive rule for allocating rights and duties upon assignment of a secured obligation. Rather, it applies only in situations involving a secondary obligor described in subsection (a). In other contexts, the agreement of the parties and applicable law other than Article 9 determine whether the assignment imposes upon the assignee any duty to the debtor and whether the assignor retains its duties to the debtor after the assignment.

Subsection (a)(1) applies when there has been an assignment of an obligation that is secured at the time it is assigned. Thus, if a secondary obligor acquires the collateral at a disposition under Section 9-610 and simultaneously or subsequently discharges the unsecured deficiency claim, subsection (a)(1) is not implicated. Similarly, subsection (a)(3) applies only when the secondary obligor is subrogated to the secured party's rights with respect to collateral. Thus, this subsection will not be implicated if a secondary obligor discharges the debtor's unsecured obligation for a post-disposition deficiency. Similarly, if the secured party disposes of some of the collateral and the secondary obligor thereafter discharges the remaining obligation, subsection (a) applies only with respect to rights and duties concerning the remaining collateral, and, under subsection (b), the subrogation is not a disposition *of the remaining collateral.*

As discussed more fully in Comment 3, a secondary obligor may receive a transfer of collateral in a disposition under Section 9-610 in exchange for a payment that is applied against the secured obligation. However, a secondary obligor who pays and receives a transfer of collateral does not necessarily become subrogated to the rights of the secured party as contemplated by subsection (a)(3). Only to the extent the secondary obligor makes a payment in satisfaction of its secondary obligation would it become subrogated. To the extent its payment constitutes the price of the collateral in a Section 9-610 disposition by the secured party, the secondary obligor would not be subrogated. Thus, if the amount paid by the secondary obligor for the collateral in a Section 9-610 disposition is itself insufficient to discharge the secured obligation, but the secondary obligor makes an additional payment that satisfies the remaining balance, the secondary obligor would be subrogated to the secured party's deficiency claim. However, the duties of the secured party *as such* would have come to an end with respect to that collateral. In some situations the capacity in which the payment is made may be unclear. Accordingly, the parties should in their relationship provide clear evidence of the nature and circumstances of the payment by the secondary obligor.

3. **Transfer of Collateral to Secondary Obligor.** It is possible for a secured party to transfer collateral to a secondary obligor in a transaction that is a disposition under Section 9-610 and that establishes a surplus or deficiency under Section 9-615. Indeed, this Article includes a special rule, in Section 9-615(f), for establishing a deficiency in the case of some dispositions to, *inter alia*, secondary obligors. This Article rejects the view, which some may have ascribed to former Section 9-504(5), that a transfer of collateral to a recourse party can *never* constitute a disposition of collateral which discharges a security interest. Inasmuch as a secured party could itself buy collateral at its own public sale, it makes no sense to prohibit a recourse party ever from buying at the sale.

4. **Timing and Scope of Obligations.** Under subsection (a), a recourse party acquires rights and incurs obligations only "after" one of the specified circumstances occurs. This makes clear that when a successor assignee, transferee, or subrogee becomes obligated it does not assume any liability for earlier actions or inactions of the secured party whom it has succeeded unless it agrees to do so. Once the successor becomes obligated, however, it is responsible for complying with the secured party's duties thereafter. For example, if the successor is in possession of collateral, then it has the duties specified in Section 9-207.

Under subsection (b), the same event (assignment, transfer, or subrogation) that gives rise to rights to, and imposes obligations on, a successor relieves its predecessor of any further duties

under this Article. For example, if the security interest is enforced after the secured obligation is assigned, the assignee but not the assignor has the duty to comply with this Part. Similarly, the assignment does not excuse the assignor from liability for failure to comply with duties that arose before the event or impose liability on the assignee for the assignor's failure to comply.

4-9-619. Transfer of record or legal title. (a) In this section, "transfer statement" means a record authenticated by a secured party stating:

(1) That the debtor has defaulted in connection with an obligation secured by specified collateral;

(2) That the secured party has exercised its post-default remedies with respect to the collateral;

(3) That, by reason of the exercise, a transferee has acquired the rights of the debtor in the collateral; and

(4) The name and mailing address of the secured party, debtor, and transferee.

(b) A transfer statement entitles the transferee to the transfer of record of all rights of the debtor in the collateral specified in the statement in any official filing, recording, registration, or certificate-of-title system covering the collateral. If a transfer statement is presented with the applicable fee and request form to the official or office responsible for maintaining the system, the official or office shall:

(1) Accept the transfer statement;

(2) Promptly amend its records to reflect the transfer; and

(3) If applicable, issue a new appropriate certificate of title in the name of the transferee.

(c) A transfer of the record or legal title to collateral to a secured party under subsection (b) of this section or otherwise is not of itself a disposition of collateral under this article and does not of itself relieve the secured party of its duties under this article.

Source: L. 2001: Entire article R&RE, p. 1413, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Transfer of Record or Legal Title.** Potential buyers of collateral that is covered by a certificate of title (e.g., an automobile) or is subject to a registration system (e.g., a copyright) typically require as a condition of their purchase that the certificate or registry reflect their ownership. In many cases, this condition can be met only with the consent of the record owner. If the record owner is the debtor and, as may be the case after the default, the debtor refuses to cooperate, the secured party may have great difficulty disposing of the collateral.

Subsection (b) provides a simple mechanism for obtaining record or legal title, for use primarily when other law does not provide one. Of course, use of this mechanism will not be effective to clear title to the extent that subsection (b) is preempted by federal law. Subsection (b) contemplates a transfer of record or legal title to a third party, following a secured party's exercise of its disposition or acceptance remedies under this Part, as well as a transfer by a debtor to a secured party prior to the secured party's exercise of those remedies. Under subsection (c), a transfer of record or legal title (under subsection (b) or under other law) to a secured party prior to the exercise of those remedies merely puts the secured party in a position to pass legal or record title to a transferee at foreclosure. A secured party who has obtained record or legal title retains its duties with respect to enforcement of its security interest, and the debtor retains its rights as well.

3. **Title-Clearing Systems Under Other Law.** Applicable non-UCC law (e.g., a certificate-of-title statute, federal registry rules, or the like) may provide a means by which the secured party may obtain or transfer record or legal title for the purpose of a disposition of the property under this Article. The mechanism provided by this section is in addition to any title-clearing provision under law other than this Article.

4-9-620. Acceptance of collateral in full or partial satisfaction of obligation - compulsory disposition of collateral. (a) Except as otherwise provided in subsection (g) of this section, a secured party may accept collateral in full or partial satisfaction of the obligation it secures only if:

(1) The debtor consents to the acceptance under subsection (c) of this section;

(2) The secured party does not receive, within the time set forth in subsection (d) of this section, a notification of objection to the proposal authenticated by:

(A) A person to which the secured party was required to send a proposal under section 4-9-621; or

(B) Any other person, other than the debtor, holding an interest in the collateral subordinate to the security interest that is the subject of the proposal;

(3) If the collateral is consumer goods, the collateral is not in the possession of the debtor when the debtor consents to the acceptance; and

(4) Subsection (e) of this section does not require the secured party to dispose of the collateral or the debtor waives the requirement pursuant to section 4-9-624.

(b) Reserved.

(c) For purposes of this section:

(1) A debtor consents to an acceptance of collateral in partial satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default; and

(2) A debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default or the secured party:

(A) Sends to the debtor after default a proposal that is unconditional or subject only to a condition that collateral not in the possession of the secured party be preserved or maintained;

(B) In the proposal, proposes to accept collateral in full satisfaction of the obligation it secures; and

(C) Does not receive a notification of objection authenticated by the debtor within twenty days after the proposal is sent.

(d) To be effective under paragraph (2) of subsection (a) of this section, a notification of objection must be received by the secured party:

(1) In the case of a person to which the proposal was sent pursuant to section 4-9-621, within twenty days after notification was sent to that person; and

(2) In other cases:

(A) Within twenty days after the last notification was sent pursuant to section 4-9-621; or

(B) If a notification was not sent, before the debtor consents to the acceptance under subsection (c) of this section.

(e) A secured party that has taken possession of collateral shall dispose of the collateral pursuant to section 4-9-610 within the time specified in subsection (f) of this section if:

(1) Sixty percent of the cash price has been paid in the case of a purchase-money security interest in consumer goods; or

(2) Sixty percent of the principal amount of the obligation secured has been paid in the case of a non-purchase-money security interest in consumer goods.

(f) To comply with subsection (e) of this section, the secured party shall dispose of the collateral:

(1) Within ninety days after taking possession; or

(2) Within any longer period to which the debtor and all secondary obligors have agreed in an agreement to that effect entered into and authenticated after default.

(g) In a consumer transaction, a secured party may not accept collateral in partial satisfaction of the obligation it secures.

Source: L. 2001: Entire article R&RE, p. 1414, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-505 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-505.

2. **Overview.** This section and the two sections following deal with strict foreclosure, a procedure by which the secured party acquires the debtor's interest in the collateral without the need for a sale or other disposition under Sec-

tion 9-610. Although these provisions derive from former Section 9-505, they have been entirely reorganized and substantially rewritten. The more straightforward approach taken in this Article eliminates the fiction that the secured party always will present a "proposal" for the retention of collateral and the debtor will have a fixed period to respond. By eliminating the need (but preserving the possibility) for proceeding in that fashion, this section eliminates much of the awkwardness of former Section 9-505. It reflects the belief that strict foreclosures should be encouraged and often will produce better results than a disposition for all concerned.

Subsection (a) sets forth the conditions necessary to an effective acceptance (formerly, retention) of collateral in full or partial satisfaction of the secured obligation. Section 9-621 requires in addition that a secured party who wishes to proceed under this section notify certain other persons who have or claim to have an interest in the collateral. Unlike the failure to meet the conditions in subsection (a), under Section 9-622(b) the failure to comply with the notification requirement of Section 9-621 does not render the acceptance of collateral ineffective. Rather, the acceptance can take effect notwithstanding the secured party's noncompliance. A person to whom the required notice was not sent has the right to recover damages under Section 9-625(b). Section 9-622(a) sets forth the effect of an acceptance of collateral.

3. **Conditions to Effective Acceptance.** Subsection (a) contains the conditions necessary to the effectiveness of an acceptance of collateral. Subsection (a)(1) requires the debtor's consent. Under subsections (c)(1) and (c)(2), the debtor may consent by agreeing to the acceptance in writing after default. Subsection (c)(2) contains an alternative method by which to satisfy the debtor's-consent condition in subsection (a)(1). It follows the proposal-and-objection model found in former Section 9-505: The debtor consents if the secured party sends a proposal to the debtor and does not receive an objection within 20 days. Under subsection (c)(1), however, that silence is not deemed to be consent with respect to acceptances in partial satisfaction. Thus, a secured party who wishes to conduct a "partial strict foreclosure" must obtain the debtor's agreement in a record authenticated after default. In all other respects, the conditions necessary to an effective partial strict foreclosure are the same as those governing acceptance of collateral in full satisfaction. (But see subsection (g), prohibiting partial strict foreclosure of a security interest in consumer transactions.)

The time when a debtor consents to a strict foreclosure is significant in several circumstances under this section and the following one. See Sections 9-620(a)(1), (d)(2), 9-621(a)(1), (a)(2), (a)(3). For purposes of determining the time of consent, a debtor's conditional consent constitutes consent.

Subsection (a)(2) contains the second condition to the effectiveness of an acceptance under this section the absence of a timely objection from a person holding a junior interest in the collateral or from a secondary obligor. Any junior party secured party or lienholder is entitled to lodge an objection to a proposal, even if that person was not entitled to notification under Section 9-621. Subsection (d), discussed below, indicates when an objection is timely.

Subsections (a)(3) and (a)(4) contain special rules for transactions in which consumers are involved. See Comment 12.

4. **Proposals.** Section 9-102 defines the term "proposal." It is necessary to send a "proposal" to the debtor only if the debtor does not agree to an acceptance in an authenticated record as described in subsection (c)(1) or (c)(2). Section 9-621(a) determines whether it is necessary to send a proposal to third parties. A proposal need not take any particular form as long as it sets forth the terms under which the secured party is willing to accept collateral in satisfaction. A proposal to accept collateral should specify the amount (or a means of calculating the amount, such as by including a per diem accrual figure) of the secured obligations to be satisfied, state the conditions (if any) under which the proposal may be revoked, and describe any other applicable conditions. Note, however, that a conditional proposal generally requires the debtor's agreement in order to take effect. See subsection (c).

5. **Secured Party's Agreement; No "Constructive" Strict Foreclosure.** The conditions of subsection (a) relate to actual or implied consent by the debtor and any secondary obligor or holder of a junior security interest or lien. To ensure that the debtor cannot unilaterally cause an acceptance of collateral, subsection (b) provides that compliance with these conditions is necessary but not sufficient to cause an acceptance of collateral. Rather, under subsection (b), acceptance does not occur unless, in addition, the secured party consents to the acceptance in an authenticated record or sends to the debtor a proposal. For this reason, a mere delay in collection or disposition of collateral does not constitute a "constructive" strict foreclosure. Instead, delay is a factor relating to whether the secured party acted in a commercially reasonable manner for purposes of Section 9-607 or 9-610. A debtor's voluntary surrender of collateral to a secured party and the secured party's acceptance of possession of the collateral does not, of itself, necessarily raise an implication that the secured party intends or is proposing to accept the collateral in satisfaction of the secured obligation under this section.

6. **When Acceptance Occurs.** This section does not impose any formalities or identify any

steps that a secured party must take in order to accept collateral once the conditions of subsections (a) and (b) have been met. Absent facts or circumstances indicating a contrary intention, the fact that the conditions have been met provides a sufficient indication that the secured party has accepted the collateral on the terms to which the secured party has consented or proposed and the debtor has consented or failed to object. Following a proposal, acceptance of the collateral normally is automatic upon the secured party's becoming bound and the time for objection passing. As a matter of good business practice, an enforcing secured party may wish to memorialize its acceptance following a proposal, such as by notifying the debtor that the strict foreclosure is effective or by placing a written record to that effect in its files. The secured party's agreement to accept collateral is self-executing and cannot be breached. The secured party is bound by its agreement to accept collateral and by any proposal to which the debtor consents.

7. **No Possession Requirement.** This section eliminates the requirement in former Section 9-505 that the secured party be "in possession" of collateral. It clarifies that intangible collateral, which cannot be possessed, may be subject to a strict foreclosure under this section. However, under subsection (a)(3), if the collateral is consumer goods, acceptance does not occur unless the debtor is not in possession.

8. **When Objection Timely.** Subsection (d) explains when an objection is timely and thus prevents an acceptance of collateral from taking effect. An objection by a person to which notification was sent under Section 9-621 is effective if it is received by the secured party within 20 days from the date the notification was sent to that person. Other objecting parties (i.e., third parties who are not entitled to notification) may object at any time within 20 days after the last notification is sent under Section 9-621. If no such notification is sent, third parties must object before the debtor agrees to the acceptance in writing or is deemed to have consented by silence. The former may occur any time after default, and the latter requires a 20-day waiting period. See subsection (c).

9. **Applicability of Other Law.** This section does not purport to regulate all aspects of the transaction by which a secured party may become the owner of collateral previously owned by the debtor. For example, a secured party's acceptance of a motor vehicle in satisfaction of secured obligations may require compliance with the applicable motor vehicle certificate-of-title law. State legislatures should conform those laws so that they mesh well with this section and Section 9-610, and courts should construe those laws and this section harmoniously. A secured party's acceptance of collateral in the possession of the debtor also may implicate statutes dealing with a seller's retention of possession of goods sold.

10. **Accounts, Chattel Paper, Payment Intangibles, and Promissory Notes.** If the collateral is accounts, chattel paper, payment intangibles, or promissory notes, then a secured party's acceptance of the collateral in satisfaction of secured obligations would constitute a sale to the secured party. That sale normally would give rise to a new security interest (the ownership interest) under Sections 1-201(37) and 9-109. In the case of accounts and chattel paper, the new security interest would remain perfected by a filing that was effective to perfect the secured party's original security interest. In the case of payment intangibles or promissory notes, the security interest would be perfected when it attaches. See Section 9-309. However, the procedures for acceptance of collateral under this section satisfy all necessary formalities and a new security agreement authenticated by the debtor would not be necessary.

11. **Role of Good Faith.** Section 1-203 imposes an obligation of good faith on a secured party's enforcement under this Article. This obligation may not be disclaimed by agreement. See Section 1-102. Thus, a proposal and acceptance made under this section in bad faith would not be effective. For example, a secured party's proposal to accept marketable securities worth $1,000 in full satisfaction of indebtedness in the amount of $100, made in the hopes that the debtor might inadvertently fail to object, would be made in bad faith. On the other hand, in the normal case proposals and acceptances should be not second-guessed on the basis of the "value" of the collateral involved. Disputes about valuation or even a clear excess of collateral value over the amount of obligations satisfied do not necessarily demonstrate the absence of good faith.

Note: "1-203" and "1-102." referenced in the first two sentences will be replaced with "1-304" and "1-302." respectively, effective July 1, 2013.

12. **Special Rules in Consumer Cases.** Subsection (e) imposes an obligation on the secured party to dispose of consumer goods under certain circumstances. Subsection (f) explains when a disposition that is required under subsection (e) is timely. An effective acceptance of collateral cannot occur if subsection (e) requires a disposition unless the debtor waives this requirement pursuant to Section 9-624(b). Moreover, a secured party who takes possession of collateral and unreasonably delays disposition violates subsection (e), if applicable, and may also violate Section 9-610 or other provisions of this Part. Subsection (e) eliminates as superfluous the express statutory reference to "conversion" found in former Section 9-505. Remedies available under other law, including conversion,

remain available under this Article in appropriate cases. See Sections 1-103, 1-106.
Note:"1-106." will be replaced with "1-305." effective July 1, 2013.

Subsection (g) prohibits the secured party in consumer transactions from accepting collateral in partial satisfaction of the obligation it secures. If a secured party attempts an acceptance in partial satisfaction in a consumer transaction, the attempted acceptance is void.

ANNOTATION

Law reviews. For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For article, "Commercial Law", see 57 Den. L.J. 165 (1980). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983).

Annotator's note. Since § 4-9-620 is similar to § 4-9-505 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Interest ripens upon retention of collateral following default. When a borrower defaults on its debt to the bank, on or before the filing in bankruptcy, the bank's interest ripens into an interest in real property by virtue of its election to retain the collateral and its compliance with this section, following the bankruptcy court's entry of the abandonment order. Swofford v. Colo. Nat'l Bank, 628 P.2d 184 (Colo. App. 1981).

Article 9 does not determine location of title after default. People ex rel. VanMeveren v. District Court, 619 P.2d 494 (Colo. 1980).

Timeliness of notice. For notice under subsection (2) to be effective, creditor's notification to debtor of his intent to retain collateral must be within sufficient time to allow commercially reasonable sale in event debtor objects. Vogel v. Carolina Intern., Inc., 711 P.2d 708 (Colo. App. 1985).

To constitute notice under this section, the secured party must act in good faith and must take steps a reasonable person would take to effect good faith notice. Vogel v. Carolina Intern., Inc., 711 P.2d 708 (Colo. App. 1985).

A secured party who retains repossessed property for an excessive period of time without compliance with the statutory provisions may not profit by the failure to furnish the requisite notice. Vogel v. Carolina Intern., Inc., 711 P.2d 708 (Colo. App. 1985).

Applied in Am. Heritage Bank & Trust Co. v. O. & E., Inc., 40 Colo. App. 306, 576 P.2d 566 (1978).

4-9-621. Notification of proposal to accept collateral. (a) A secured party that desires to accept collateral in full or partial satisfaction of the obligation it secures shall send its proposal to:

(1) Any person from which the secured party has received, before the debtor consented to the acceptance, an authenticated notification of a claim of an interest in the collateral;

(2) Any other secured party or lienholder that, ten days before the debtor consented to the acceptance, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

(A) Identified the collateral;

(B) Was indexed under the debtor's name as of that date; and

(C) Was filed in the office or offices in which to file a financing statement against the debtor covering the collateral as of that date; and

(3) Any other secured party that, ten days before the debtor consented to the acceptance, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in section 4-9-311 (a).

(b) A secured party that desires to accept collateral in partial satisfaction of the obligation it secures shall send its proposal to any secondary obligor in addition to the persons described in subsection (a) of this section.

Source: L. 2001: Entire article R&RE, p. 1415, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-505 as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-505.

2. **Notification Requirement.** Subsection (a) specifies three classes of competing claimants to whom the secured party must send notification of its proposal: (i) those who notify the secured party that they claim an interest in the collateral, (ii) holders of certain security interests and liens who have filed against the debtor, and (iii) holders of certain security interests who have perfected by compliance with a statute (including a certificate-of-title statute), regulation, or treaty described in Section 9-311(a). With regard to (ii), see Section 9-611, Comment 4. Subsection (b) also requires notification to any secondary obligor if the proposal is for acceptance in partial satisfaction.

Unlike Section 9-611, this section contains no "safe harbor," which excuses an enforcing secured party from notifying certain secured parties and other lienholders. This is because, unlike Section 9-610, which requires that a disposition of collateral be commercially reasonable, Section 9-620 permits the debtor and secured party to set the amount of credit the debtor will receive for the collateral subject only to the requirement of good faith. An effective acceptance discharges subordinate security interests and other subordinate liens. See Section 9-622. If collateral is subject to several liens securing debts much larger than the value of the collateral, the debtor may be disinclined to refrain from consenting to an acceptance by the holder of the senior security interest, even though, had the debtor objected and the senior disposed of the collateral under Section 9-610, the collateral may have yielded more than enough to satisfy the senior security interest (but not enough to satisfy all the liens). Accordingly, this section imposes upon the enforcing secured party the risk of the filing office's errors and delay. The holder of a security interest who is entitled to notification under this section but does not receive it has the right to recover under Section 9-625(b) any loss resulting from the enforcing secured party's noncompliance with this section.

Note: This version of this paragraph is effective until July 1, 2013.

[Unlike Section 9-611, this section contains no "safe harbor," which excuses an enforcing secured party from notifying certain secured parties and other lienholders. This is because, unlike Section 9-610, which requires that a disposition of collateral be commercially reasonable, Section 9-620 permits the debtor and secured party to set the amount of credit the debtor will receive for the collateral subject only to the requirement of good faith. An effective acceptance discharges subordinate security interests and other subordinate liens. See Section 9-622. If collateral is subject to several liens securing debts much larger than the value of the collateral, the debtor may be disinclined to refrain from consenting to an acceptance by the holder of the senior security interest, even though, had the debtor objected and the senior disposed of the collateral under Section 9-610, the collateral may have yielded more than enough to satisfy the senior security interest (but not enough to satisfy all the liens). Accordingly, this section imposes upon the enforcing secured party the risk of the filing office's errors and delay. The holder of a security interest who is entitled to notification under this section but to whom the enforcing secured party does not send notification has the right to recover under Section 9-625(b) any loss resulting from the secured party's noncompliance with this section.]

Note: This version of this paragraph takes effect July 1, 2013.

ANNOTATION

Law reviews. For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For article, "Commercial Law", see 57 Den. L.J. 165 (1980). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983).

Annotator's note. Section 4-9-621 is similar to § 4-9-505 as it existed prior to the 2001 repeal and reenactment of this article. Relevant cases construing § 4-9-505 have been included in the annotations to § 4-9-620.

4-9-622. Effect of acceptance of collateral. (a) A secured party's acceptance of collateral in full or partial satisfaction of the obligation it secures:

(1) Discharges the obligation to the extent consented to by the debtor;

(2) Transfers to the secured party all of a debtor's rights in the collateral;

(3) Discharges the security interest or agricultural lien that is the subject of the debtor's consent and any subordinate security interest or other subordinate lien; and

(4) Terminates any other subordinate interest.

(b) A subordinate interest is discharged or terminated under subsection (a) of this section, even if the secured party fails to comply with this article.

Source: L. 2001: Entire article R&RE, p. 1416, § 1, effective July 1.

OFFICIAL COMMENT

1. **Source.** New.

2. **Effect of Acceptance.** Subsection (a) specifies the effect of an acceptance of collateral in full or partial satisfaction of the secured obligation. The acceptance to which it refers is an effective acceptance. If a purported acceptance is ineffective under Section 9-620, e.g., because the secured party receives a timely objection from a person entitled to notification, then neither this subsection nor subsection (b) applies. Paragraph (1) expresses the fundamental consequence of accepting collateral in full or partial satisfaction of the secured obligation the obligation is discharged to the extent consented to by the debtor. Unless otherwise agreed, the obligor remains liable for any deficiency. Paragraphs (2) through (4) indicate the effects of an acceptance on various property rights and interests. Paragraph (2) follows Section 9-617(a) in providing that the secured party acquires "all of a debtor's rights in the collateral." Under paragraph (3), the effect of strict foreclosure on holders of junior security interests and other liens is the same regardless of whether the collateral is accepted in full or partial satisfaction of the secured obligation: all junior encumbrances are discharged. Paragraph (4) provides for the termination of other subordinate interests.

Subsection (b) makes clear that subordinate interests are discharged under subsection (a) regardless of whether the secured party complies with this Article. Thus, subordinate interests are discharged regardless of whether a proposal was required to be sent or, if required, was sent. However, a secured party's failure to send a proposal or otherwise to comply with this Article may subject the secured party to liability under Section 9-625.

4-9-623. Right to redeem collateral. (a) A debtor, any secondary obligor, or any other secured party or lienholder may redeem collateral.

(b) To redeem collateral, a person shall tender:

(1) Fulfillment of all obligations secured by the collateral; and

(2) The reasonable expenses and reasonable attorney's fees described in section 4-9-615 (a) (1).

(c) A redemption may occur at any time before a secured party:

(1) Has collected collateral under section 4-9-607;

(2) Has disposed of collateral or entered into a contract for its disposition under section 4-9-610; or

(3) Has accepted collateral in full or partial satisfaction of the obligation it secures under section 4-9-622.

Source: L. 2001: Entire article R&RE, p. 1416, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 4-9-506 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado added the word "reasonable" before the word "attorney's" in subsection (b)(2).

OFFICIAL COMMENT

1. **Source.** Former Section 9-506.

2. **Redemption Right.** Under this section, as under former Section 9-506, the debtor or another secured party may redeem collateral as long as the secured party has not collected (Section 9-607), disposed of or contracted for the disposition of (Section 9-610), or accepted (Section 9-620) the collateral. Although this section generally follows former Section 9-506, it extends the right of redemption to holders of nonconsensual liens. To redeem the collateral a person must tender fulfillment of all obligations secured, plus certain expenses. If the entire balance of a secured obligation has been accelerated, it would be necessary to tender the entire balance. A tender of fulfillment obviously means more than a new promise to perform an existing promise. It requires payment in full of all monetary obligations then due and performance in full of all other obligations then matured. If unmatured secured obligations remain, the security interest continues to secure them (i.e., as if there had been no default).

3. **Redemption of Remaining Collateral Following Partial Enforcement.** Under Section 9-610 a secured party may make successive dispositions of portions of its collateral. These dispositions would not affect the debtor's, another secured party's, or a lienholder's right to redeem the remaining collateral.

4. **Effect of "Repledging."** Section 9-207 generally permits a secured party having possession or control of collateral to create a security interest in the collateral. As explained in the Comments to that section, the debtor's right (as opposed to its practical ability) to redeem collateral is not affected by, and does not affect, the priority of a security interest created by the debtor's secured party.

ANNOTATION

Law reviews. For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983). For article, "A Review of Agricultural Law: Hard Times and Hard Choices", see 15 Colo. Law. 629 (1986). For article, "The Colorado Farm Homestead Protection Act", see 15 Colo. Law. 1642 (1986). For article, "Agricultural Lending in a Troubled Economy", see 16 Colo. Law. 1773 (1987). For article, "The Agricultural Credit Act of 1987", see 17 Colo. Law. 611 (1988).

Annotator's note. Since § 4-9-623 is similar to § 4-9-506 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Applied in H.M.O. Sys. v. Choicecare Health Servs., Inc., 665 P.2d 635 (Colo. App. 1983); Task Enterprises, Inc. v. Pratt Adjustment Co., 695 P.2d 762 (Colo. App. 1984).

4-9-624. Waiver. (a) A debtor or secondary obligor may waive the right to notification of disposition of collateral under section 4-9-611 only by an agreement to that effect entered into and authenticated after default.

(b) A debtor may waive the right to require disposition of collateral under section 4-9-620 (e) only by an agreement to that effect entered into and authenticated after default.

(c) Except in a consumer-goods transaction, a debtor or secondary obligor may waive the right to redeem collateral under section 4-9-623. Any such waiver must be by an agreement to that effect entered into and authenticated after default.

Source: L. 2001: Entire article R&RE, p. 1417, § 1, effective July 1.

Editor's note: (1) The provisions of this section are similar to provisions of several former sections as they existed prior to 2001. For a detailed comparison, see the comparative tables located in the back of the index.

(2) **Colorado legislative change:** Colorado added the phrase "Any such waiver must be" in subsection (c).

OFFICIAL COMMENT

1. **Source.** Former Sections 9-504(3), 9-505, 9-506.

2. **Waiver.** This section is a limited exception to Section 9-602, which generally prohibits waiver by debtors and obligors. It makes no provision for waiver of the rule prohibiting a secured party from buying at its own private disposition. Transactions of this kind are equivalent to "strict foreclosures" and are governed by Sections 9-620, 9-621, and 9-622.

ANNOTATION

Law reviews. For comment, "Remedies for Failure to Notify Debtor of Disposition of Repossessed Collateral Under the U.C.C.", see 44 U. Colo. L. Rev. 221 (1972). For article, "Buyer-Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code", see 46 U. Colo. L. Rev. 333 (1974-75). For article, "Commercial Law", see 55 Den. L.J. 425 (1978). For article, "Secured Transactions — Part I: Attachment, Perfection and Priorities", see 11 Colo. Law. 2939 (1982). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983). For article, "A Review of Agricultural Law: Hard Times and Hard Choices", see 15 Colo. Law. 629 (1986). For article, "The Colorado Farm Homestead Protection Act", see 15 Colo. Law. 1642 (1986). For article, "Agricultural Lending in a Troubled Economy", see 16 Colo. Law. 1773 (1987). For article, "The Agricultural Credit Act of 1987", see 17 Colo. Law. 611 (1988).

Annotator's note. Section 4-9-624 is similar to § 4-9-504 as it existed prior to the 2001

repeal and reenactment of this article. Relevant cases construing § 4-9-504 have been included in the annotations to § 4-9-610.

4-9-625. Remedies for secured party's failure to comply with article. (a) If it is established that a secured party is not proceeding in accordance with this article, a court may order or restrain collection, enforcement, or disposition of collateral on appropriate terms and conditions.

(b) Subject to subsections (c), (d), and (f) of this section, a person is liable for damages in the amount of any loss caused by a failure to comply with this article. Loss caused by a failure to comply may include loss resulting from the debtor's inability to obtain, or increased costs of, alternative financing.

(c) Except as otherwise provided in section 4-9-628:

(1) A person that, at the time of the failure, was a debtor, was an obligor, or held a security interest in or other lien on the collateral may recover damages under subsection (b) of this section for its loss; and

(2) If the collateral is consumer goods, a person that was a debtor or secondary obligor at the time a secured party failed to comply with this part 6 may recover for that failure in any event an amount not less than the credit service charge plus ten percent of the principal amount of the obligation or the time-price differential plus ten percent of the cash price.

(d) A debtor whose deficiency is eliminated under section 4-9-626 may recover damages for the loss of any surplus. However, a debtor or secondary obligor whose deficiency is eliminated or reduced under section 4-9-626 may not otherwise recover under subsection (b) of this section for noncompliance with the provisions of this part 6 relating to collection, enforcement, disposition, or acceptance.

(e) In addition to any damages recoverable under subsection (b) of this section, the debtor, consumer obligor, or person named as a debtor in a filed record, as applicable, may recover five hundred dollars in each case from a person that:

(1) Fails to comply with section 4-9-208;

(2) Fails to comply with section 4-9-209;

(3) Files a record that the person is not entitled to file under section 4-9-509 (a);

(4) Fails to cause the secured party of record to file or send a termination statement as required by section 4-9-513 (a) or (c);

(5) Fails to comply with section 4-9-616 (b) (1) and whose failure is part of a pattern, or consistent with a practice, of noncompliance; or

(6) Fails to comply with section 4-9-616 (b) (2).

(f) A debtor or consumer obligor may recover damages under subsection (b) of this section and, in addition, five hundred dollars in each case from a person that, without reasonable cause, fails to comply with a request under section 4-9-210. A recipient of a request under section 4-9-210 which never claimed an interest in the collateral or obligations that are the subject of a request under that section has a reasonable excuse for failure to comply with the request within the meaning of this subsection (f).

(g) If a secured party fails to comply with a request regarding a list of collateral or a statement of account under section 4-9-210, the secured party may claim a security interest only as shown in the list or statement included in the request as against a person that is reasonably misled by the failure.

(h) If a person in the course of taking possession of collateral by self-help breaches the peace as defined in paragraph (1), (2), or (3) of subsection (h) of section 4-9-601 or uses uniformed law enforcement officers without the benefit of judicial process, that person shall be liable to the debtor for one thousand dollars as a penalty.

(i) The prevailing party in any legal action, other than a class action, under this section may also recover reasonable attorney's fees and reasonable legal expenses; except that as to consumer transactions, such attorney's fees for any party shall not exceed fifteen percent of the unpaid debt or such additional fee as may be directed by the court.

(j) The number "five hundred dollars" as provided in subsections (e) and (f) of this section shall be increased on July 1, 2004, and on July 1 of each third succeeding year in accordance with any aggregate increase in the United States department of labor bureau of

labor statistics consumer price index for all urban consumers for the Denver-Boulder consolidated metropolitan statistical area for the preceding three calendar years as reflected in the final consumer price index for the Denver-Boulder consolidated metropolitan statistical area for the calendar year immediately preceding the calendar year in which the adjustment is to be made; except that:

(1) Such dollar amount shall not be increased if such final consumer price index does not reflect an aggregate increase in the consumer price index for the preceding three calendar years and shall be decreased if such final consumer price index reflects an aggregate decrease in the consumer price index for the preceding three calendar years.

(2) The dollar amount as adjusted pursuant to this subsection (j) shall be rounded to the nearest ten dollars.

Source: L. 2001: Entire article R&RE, p. 1417, § 1, effective July 1. **L. 2002:** (j)(1) amended, p. 939, § 8, effective August 7.

Editor's note: (1) This section is similar to former § 4-9-507 as it existed prior to 2001.

(2) **Colorado legislative change:** Colorado did not adopt the phrase "with a request under section 4-9-210" after the word "comply" in the second sentence of subsection (b), added the phrase "list or" in subsection (g), and added subsections (h) through (j).

OFFICIAL COMMENT

1. **Source.** Former Section 9-507.

2. **Remedies for Noncompliance; Scope.** Subsections (a) and (b) provide the basic remedies afforded to those aggrieved by a secured party's failure to comply with this Article. Like all provisions that create liability, they are subject to Section 9-628, which should be read in conjunction with Section 9-605. The principal limitations under this Part on a secured party's right to enforce its security interest against collateral are the requirements that it proceed in good faith (Section 1-203), in a commercially reasonable manner (Sections 9-607 and 9-610), and, in most cases, with reasonable notification (Sections 9-611 through 9-614). Following former Section 9-507, under subsection (a) an aggrieved person may seek injunctive relief, and under subsection (b) the person may recover damages for losses caused by noncompliance. Unlike former Section 9-507, however, subsections (a) and (b) are not limited to noncompliance with provisions of this Part of Article 9. Rather, they apply to noncompliance with any provision of this Article. The change makes this section applicable to noncompliance with Sections 9-207 (duties of secured party in possession of collateral), 9-208 (duties of secured party having control over deposit account), 9-209 (duties of secured party if account debtor has been notified of an assignment), 9-210 (duty to comply with request for accounting, etc.), 9-509(a) (duty to refrain from filing unauthorized financing statement), and 9-513(a) or (c) (duty to provide termination statement). Subsection (a) also modifies the first sentence of former Section 9-507(1) by adding the references to "collection" and "enforcement." Subsection (c)(2), which gives a minimum damage recovery in consumer-goods transactions, applies only to noncompliance with the provisions of this Part.

3. **Damages for Noncompliance with This Article.** Subsection (b) sets forth the basic remedy for failure to comply with the requirements of this Article: a damage recovery in the amount of loss caused by the noncompliance. Subsection (c) identifies who may recover under subsection (b). It affords a remedy to any aggrieved person who is a debtor or obligor. However, a principal obligor who is not a debtor may recover damages only for noncompliance with Section 9-616, inasmuch as none of the other rights and duties in this Article run in favor of such a principal obligor. Such a principal obligor could not suffer any loss or damage on account of noncompliance with rights or duties of which it is not a beneficiary. Subsection (c) also affords a remedy to an aggrieved person who holds a competing security interest or other lien, regardless of whether the aggrieved person is entitled to notification under Part 6. The remedy is available even to holders of senior security interests and other liens. The exercise of this remedy is subject to the normal rules of pleading and proof. A person who has delegated the duties of a secured party but who remains obligated to perform them is liable under this subsection. The last sentence of subsection (d) eliminates the possibility of double recovery or other over-compensation arising out of a reduction or elimination of a deficiency under Section 9-626, based on noncompliance with the provisions of this Part relating to collection, enforcement, disposition, or acceptance. Assuming no double recovery, a debtor whose deficiency is eliminated under Section 9-626 may pursue a claim for a surplus. Because Section 9-626 does not apply to consumer transactions, the statute is

silent as to whether a double recovery or other over-compensation is possible in a consumer transaction.

Damages for violation of the requirements of this Article, including Section 9-609, are those reasonably calculated to put an eligible claimant in the position that it would have occupied had no violation occurred. See Section 1-106. Subsection (b) supports the recovery of actual damages for committing a breach of the peace in violation of Section 9-609, and principles of tort law supplement this subsection. See Section 1-103. However, to the extent that damages in tort compensate the debtor for the same loss dealt with by this Article, the debtor should be entitled to only one recovery.

4. **Minimum Damages in Consumer-Goods Transactions.** Subsection (c)(2) provides a minimum, statutory, damage recovery for a debtor and secondary obligor in a consumer-goods transaction. It is patterned on former Section 9-507(1) and is designed to ensure that every noncompliance with the requirements of Part 6 in a consumer-goods transaction results in liability, regardless of any injury that may have resulted. Subsection (c)(2) leaves the treatment of statutory damages as it was under former Article 9. A secured party is not liable for statutory damages under this subsection more than once with respect to any one secured obligation (see Section 9-628(e)), nor is a secured party liable under this subsection for failure to comply with Section 9-616 (see Section 9-628(d)).

Following former Section 9-507(1), this Article does not include a definition or explanation of the terms "credit service charge," "principal amount," "time-price differential," or "cash price," as used in subsection (c)(2). It leaves their construction and application to the court, taking into account the subsection's purpose of providing a minimum recovery in consumer-goods transactions.

5. **Supplemental Damages.** Subsections (e) and (f) provide damages that supplement the recovery, if any, under subsection (b). Subsection (e) imposes an additional $500 liability upon a person who fails to comply with the provisions specified in that subsection, and subsection (f) imposes like damages on a person who, without reasonable excuse, fails to comply with a request for an accounting or a request regarding a list of collateral or statement of account under Section 9-210. However, under subsection (f), a person has a reasonable excuse for the failure if the person never claimed an interest in the collateral or obligations that were the subject of the request.

6. **Estoppel.** Subsection (g) limits the extent to which a secured party who fails to comply with a request regarding a list of collateral or statement of account may claim a security interest.

ANNOTATION

I. GENERAL CONSIDERATION.

Law reviews. For article, "Commercial Law", see 55 Den. L.J. 425 (1978). For article, "Commercial Law", see 57 Den. L.J. 165 (1980).

Annotator's note. Since § 4-9-625 is similar to § 4-9-507 as it existed prior to the 2001 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Consequential damages are not recoverable under former § 4-9-507 (1); therefore, plaintiff is not entitled to damages for alleged lost profits. Proactive Techs., Inc. v. Denver Place Assocs. Ltd. P'ship, 141 P.3d 959 (Colo. App. 2006).

Applied in Young v. Golden State Bank, 39 Colo. App. 45, 560 P.2d 855 (1977); Am. Heritage Bank & Trust Co. v. O. & E., Inc., 40 Colo. App. 306, 576 P.2d 566 (1978); Young v. Golden State Bank, 41 Colo. App. 480, 589 P.2d 1381 (1978); Western Nat'l Bank v. VFW Post 8103, 660 P.2d 919 (Colo. App. 1983); Padilla v. Ghuman, 183 P.3d 653 (Colo. App. 2007).

II. SECURED PARTY'S LIABILITY.

Law reviews. For comment, "Remedies for Failure to Notify Debtor of Disposition of Repossessed Collateral Under the U.C.C.", see 44 U. Colo. L. Rev. 221 (1972).

This section establishes the right of a debtor to recover from the secured party any loss sustained where a secured party fails to give notice of sale to the debtor as required by § 4-9-504(3). Cmty. Mgt. Ass'n of Colo. Springs, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973).

If the collateral is consumer goods, the minimum recovery by the debtors would be the time price differential plus ten percent of the cash price. Cmty. Mgt. Ass'n of Colo. Springs, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973).

Subsection (1) penalty appropriate for violation of § 5-5-112. An appropriate penalty for the violation of § 5-5-112 is the penalty imposed by subsection (1). D.E.B. Adjustment Co. v. Cawthorne, 623 P.2d 82 (Colo. App. 1981).

III. MARKET VALUE.

Evidence of market value. Where sale is conducted in accordance with the requirements

of the code, the amount received at the sale of collateral is evidence of the market value, but where sale is not conducted in compliance with the law, the amount received is not evidence of the market value of the collateral, and the secured party has the burden of proving the market value by other evidence. Cmty. Mgt. Ass'n of Colo. Springs, Inc. v. Tousley, 32 Colo. App. 33, 505 P.2d 1314 (1973).

A sale price which is less than the fair market value or the appraised value is not dispositive of commercial unreasonableness. Nor does a sale price that is less than what the debtor expected necessarily constitute commercial unreasonableness. Flexisystems, Inc. v. Am. Standards Testing Bureau, Inc., 847 P.2d 207 (Colo. App. 1992).

4-9-626. Action in which deficiency or surplus is in issue. (a) In an action arising from a transaction, other than a consumer transaction, in which the amount of a deficiency or surplus is in issue, the following rules apply:

(1) A secured party need not prove compliance with the provisions of this part 6 relating to collection, enforcement, disposition, or acceptance unless the debtor or a secondary obligor places the secured party's compliance in issue.

(2) If the secured party's compliance is placed in issue, the secured party has the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with this part 6.

(3) Except as otherwise provided in section 4-9-628, if a secured party fails to prove that the collection, enforcement, disposition, or acceptance was conducted in accordance with the provisions of this part 6 relating to collection, enforcement, disposition, or acceptance, the liability of a debtor or a secondary obligor for a deficiency is limited to an amount by which the sum of the secured obligation, reasonable expenses, and reasonable attorney's fees exceeds the greater of:

(A) The proceeds of the collection, enforcement, disposition, or acceptance; or

(B) The amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with the provisions of this part 6 relating to collection, enforcement, disposition, or acceptance.

(4) For purposes of subparagraph (B) of paragraph (3) of this subsection (a), the amount of proceeds that would have been realized is equal to the sum of the secured obligation, reasonable expenses, and reasonable attorney's fees unless the secured party proves that the amount is less than that sum.

(5) If a deficiency or surplus is calculated under section 4-9-615 (f), the debtor or obligor has the burden of establishing that the amount of proceeds of the disposition is significantly below the range of prices that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(b) Subject to section 5-5-103, C.R.S., the limitation of the rules in subsection (a) of this section to transactions other than consumer transactions is intended to leave to the court the determination of the proper rules in consumer transactions. The court may not infer from that limitation the nature of the proper rule in consumer transactions and may continue to apply established approaches.

Source: L. 2001: Entire article R&RE, p. 1419, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado added the word "reasonable" to subsections (a)(3) and (a)(4) and added the phrase "Subject to section 5-5-103, C.R.S.," to subsection (b).

OFFICIAL COMMENT

1. **Source.** New.

2. **Scope.** The basic damage remedy under Section 9-625(b) is subject to the special rules in this section for transactions other than consumer transactions. This section addresses situations in which the amount of a deficiency or surplus is in issue, i.e., situations in which the secured party has collected, enforced, disposed of, or accepted the collateral. It contains special rules applicable to a determination of the amount of a deficiency or surplus. Because this section affects a person's liability for a deficiency, it is subject to Section 9-628, which should be read in conjunction with Section 9-605. The rules in this section

apply only to noncompliance in connection with the "collection, enforcement, disposition, or acceptance" under Part 6. For other types of noncompliance with Part 6, the general liability rule of Section 9-625(b) recovery of actual damages applies. Consider, for example, a repossession that does not comply with Section 9-609 for want of a default. The debtor's remedy is under Section 9-625(b). In a proper case, the secured party also may be liable for conversion under non-UCC law. If the secured party thereafter disposed of the collateral, however, it would violate Section 9-610 at that time, and this section would apply.

3. **Rebuttable Presumption Rule.** Subsection (a) establishes the rebuttable presumption rule for transactions other than consumer transactions. Under paragraph (1), the secured party need not prove compliance with the relevant provisions of this Part as part of its prima facie case. If, however, the debtor or a secondary obligor raises the issue (in accordance with the forum's rules of pleading and practice), then the secured party bears the burden of proving that the collection, enforcement, disposition, or acceptance complied. In the event the secured party is unable to meet this burden, then paragraph (3) explains how to calculate the deficiency. Under this rebuttable presumption rule, the debtor or obligor is to be credited with the greater of the actual proceeds of the disposition or the proceeds that would have been realized had the secured party complied with the relevant provisions. If a deficiency remains, then the secured party is entitled to recover it. The references to "the secured obligation, expenses, and attorney's fees" in paragraphs (3) and (4) embrace the application rules in Sections 9-608(a) and 9-615(a).

Unless the secured party proves that compliance with the relevant provisions would have yielded a smaller amount, under paragraph (4) the amount that a complying collection, enforcement, or disposition would have yielded is deemed to be equal to the amount of the secured obligation, together with expenses and attorney's fees. Thus, the secured party may not recover any deficiency unless it meets this burden.

4. **Consumer Transactions.** Although subsection (a) adopts a version of the rebuttable presumption rule for transactions other than consumer transactions, with certain exceptions Part 6 does not specify the effect of a secured party's noncompliance in consumer transactions. (The exceptions are the provisions for the recovery of damages in Section 9-625.) Subsection (b) provides that the limitation of subsection (a) to transactions other than consumer transactions is intended to leave to the court the determination of the proper rules in consumer transactions. It also instructs the court not to draw any inference from the limitation as to the proper rules for consumer transactions and leaves the court free to continue to apply established approaches to those transactions.

Courts construing former Section 9-507 disagreed about the consequences of a secured party's failure to comply with the requirements of former Part 5. Three general approaches emerged. Some courts have held that a noncomplying secured party may not recover a deficiency (the "absolute bar" rule). A few courts held that the debtor can offset against a claim to a deficiency all damages recoverable under former Section 9-507 resulting from the secured party's noncompliance (the "offset" rule). A plurality of courts considering the issue held that the noncomplying secured party is barred from recovering a deficiency unless it overcomes a rebuttable presumption that compliance with former Part 5 would have yielded an amount sufficient to satisfy the secured debt. In addition to the nonuniformity resulting from court decisions, some States enacted special rules governing the availability of deficiencies.

5. **Burden of Proof When Section 9-615(f) Applies.** In a non-consumer transaction, subsection (a)(5) imposes upon a debtor or obligor the burden of proving that the proceeds of a disposition are so low that, under Section 9-615(f), the actual proceeds should not serve as the basis upon which a deficiency or surplus is calculated. Were the burden placed on the secured party, then debtors might be encouraged to challenge the price received in every disposition to the secured party, a person related to the secured party, or a secondary obligor.

6. **Delay in Applying This Section.** There is an inevitable delay between the time a secured party engages in a noncomplying collection, enforcement, disposition, or acceptance and the time of a subsequent judicial determination that the secured party did not comply with Part 6. During the interim, the secured party, believing that the secured obligation is larger than it ultimately is determined to be, may continue to enforce its security interest in collateral. If some or all of the secured indebtedness ultimately is discharged under this section, a reasonable application of this section would impose liability on the secured party for the amount of any excess, unwarranted recoveries but would not make the enforcement efforts wrongful.

4-9-627. Determination of whether conduct was commercially reasonable. (a) The fact that a greater amount could have been obtained by a collection, enforcement, disposition, or acceptance at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing

that the collection, enforcement, disposition, or acceptance was made in a commercially reasonable manner.

(b) A disposition of collateral is made in a commercially reasonable manner if the disposition is made:

(1) In the usual manner on any recognized market;

(2) At the price current in any recognized market at the time of the disposition; or

(3) Otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

(c) A collection, enforcement, disposition, or acceptance is commercially reasonable if it has been approved:

(1) In a judicial proceeding;

(2) By a bona fide creditors' committee;

(3) By a representative of creditors; or

(4) By an assignee for the benefit of creditors.

(d) Approval under subsection (c) of this section need not be obtained, and lack of approval does not mean that the collection, enforcement, disposition, or acceptance is not commercially reasonable.

Source: L. 2001: Entire article R&RE, p. 1420, § 1, effective July 1.

Editor's note: This section is similar to former § 4-9-507 (2) as it existed prior to 2001.

OFFICIAL COMMENT

1. **Source.** Former Section 9-507(2).

2. **Relationship of Price to Commercial Reasonableness.** Some observers have found the notion contained in subsection (a) (derived from former Section 9-507(2)) (the fact that a better price could have been obtained does not establish lack of commercial reasonableness) to be inconsistent with that found in Section 9-610(b) (derived from former Section 9-504(3) (every aspect of the disposition, including its terms, must be commercially reasonable). There is no such inconsistency. While not itself sufficient to establish a violation of this Part, a low price suggests that a court should scrutinize carefully all aspects of a disposition to ensure that each aspect was commercially reasonable.

The law long has grappled with the problem of dispositions of personal and real property which comply with applicable procedural requirements (e.g., advertising, notification to interested persons, etc.) but which yield a price that seems low. This Article addresses that issue in Section 9-615(f). That section applies only when the transferee is the secured party, a person related to the secured party, or a secondary obligor. It contains a special rule for calculating a deficiency or surplus in a complying disposition that yields a price that is "significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought."

3. **Determination of Commercial Reasonableness; Advance Approval.** It is important to make clear the conduct and procedures that are commercially reasonable and to provide a secured party with the means of obtaining, by court order or negotiation with a creditors' committee or a representative of creditors, advance approval of a proposed method of enforcement as commercially reasonable. This section contains rules that assist in that determination and provides for advance approval in appropriate situations. However, none of the specific methods of disposition specified in subsection (b) is required or exclusive.

4. **"Recognized Market."** As in Sections 9-610(c) and 9-611(d), the concept of a "recognized market" in subsections (b)(1) and (2) is quite limited; it applies only to markets in which there are standardized price quotations for property that is essentially fungible, such as stock exchanges.

ANNOTATION

Law reviews. For article, "Commercial Law", see 55 Den. L.J. 425 (1978). For article, "Commercial Law", see 57 Den. L.J. 165 (1980).

Annotator's note. Section 4-9-627 is similar to § 4-9-507 as it existed prior to the 2001 repeal and reenactment of this article. Relevant cases construing § 4-9-507 have been included in the annotations to § 4-9-625.

4-9-628. Nonliability and limitation on liability of secured party - liability of secondary obligor. (a) Unless a secured party knows that a person is a debtor or obligor, knows the identity of the person, and knows how to communicate with the person:

(1) The secured party is not liable to the person, or to a secured party or lienholder that has filed a financing statement against the person, for failure to comply with this article; and

(2) The secured party's failure to comply with this article does not affect the liability of the person for a deficiency.

(b) A secured party is not liable because of its status as secured party:

(1) To a person that is a debtor or obligor, unless the secured party knows:

(A) That the person is a debtor or obligor;

(B) The identity of the person; and

(C) How to communicate with the person; or

(2) To a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:

(A) That the person is a debtor; and

(B) The identity of the person.

(c) A secured party is not liable to any person, and a person's liability for a deficiency is not affected, because of any act or omission arising out of the secured party's reasonable belief that a transaction is not a consumer-goods transaction or a consumer transaction or that goods are not consumer goods, if the secured party's belief is based on its reasonable reliance on:

(1) A record authenticated by the debtor concerning the purpose for which collateral was to be used, acquired, or held, or indicating that collateral is not a consumer deposit account; or

(2) A record authenticated by the obligor concerning the purpose for which a secured obligation was incurred.

(d) (1) A secured party is not liable under section 4-9-625 (c) (2) for its failure to comply with section 4-9-616.

(2) Repealed.

(e) A secured party is not liable under section 4-9-625 (c) (2) more than once with respect to any one secured obligation.

Source: L. 2001: Entire article R&RE, p. 1421, § 1, effective July 1. **L. 2002:** (d)(2) repealed, p. 939, § 9, effective August 7.

Editor's note - Colorado legislative change: Colorado substituted the phrase "A record authenticated by the debtor" for the phrase "A debtor's representation" and added the phrase "or indicating that collateral is not a consumer deposit account" in subsection (c)(1), substituted the phrase "A record authenticated by the obligor" for the phrase "An obligor's representation" in subsection (c)(2), and did not adopt subsection (d) of the uniform act. The uniform act's subsection (e) states: "A secured party is not liable under section 4-9-625(c)(2) more than once with respect to any one secured obligation."

OFFICIAL COMMENT

1. **Source.** New.

2. **Exculpatory Provisions.** Subsections (a), (b), and (c) contain exculpatory provisions that should be read in conjunction with Section 9-605. Without this group of provisions, a secured party could incur liability to unknown persons and under circumstances that would not allow the secured party to protect itself. The broadened definition of the term "debtor" underscores the need for these provisions.

If a secured party reasonably, but mistakenly, believes that a consumer transaction or consumer-goods transaction is a non-consumer transaction or non-consumer-goods transaction, and if the secured party's belief is based on its reasonable reliance on a representation of the type specified in subsection (c)(1) or (c)(2), then this Article should be applied as if the facts reasonably believed and the representation reasonably relied upon were true. For example, if a secured party reasonably believed that a transaction was a non-consumer transaction and its belief was based on reasonable reliance on the debtor's representation that the collateral secured an obligation incurred for business purposes, the secured party is not liable to any person, and the debtor's liability for a deficiency is not affected, because of any act or omission of

the secured party which arises out of the reasonable belief. Of course, if the secured party's belief is not reasonable or, even if reasonable, is not based on reasonable reliance on the debtor's representation, this limitation on liability is inapplicable.

3. **Inapplicability of Statutory Damages to Section 9-616.** Subsection (d) excludes noncompliance with Section 9-616 entirely from the scope of statutory damage liability under Section 9-625(c)(2).

4. **Single Liability for Statutory Minimum Damages.** Subsection (e) ensures that a secured party will incur statutory damages only once in connection with any one secured obligation.

4-9-629. Secured party's liability when taking possession after default - legislative declaration - fund. (a) The general assembly recognizes that, in the past, certain debtors may have been disadvantaged by the actions of repossessors and that such debtors were then unable to obtain just redress for their losses in the courts, especially in cases in which the creditor who initiated the action by employing or contracting with the repossessor was shielded from liability because the repossessor was categorized by the courts as an independent contractor. The general assembly wishes to ensure that the repossessor is bonded or that the secured party or assignee is held responsible at law as a principal under the general principles of agency law for the actions of a repossessor who is acting at the behest of the creditor in the event that no bond has been posted.

(b) A secured party or such party's assignee who wishes to contract with a person to recover or take possession of collateral upon default, including a motor vehicle repossessed pursuant to section 42-6-146, C.R.S., shall contract to recover or take possession of collateral only with a person who is bonded for property damage to or conversion of such collateral in the amount of at least fifty thousand dollars. Such bond shall be filed with and drawn in favor of the attorney general of the state of Colorado for use of the people of the state of Colorado, and shall be revocable only with the written consent of the attorney general pursuant to rules promulgated by the office of the attorney general. The office of the attorney general may charge a fee to be paid by the person filing such bond in order to cover the direct and indirect costs incurred by such office in fulfilling its duties under the provisions of this section.

(c) A secured party or secured party's assignee who employs or contracts with a person who has not complied with the requirements specified in subsection (b) of this section shall be liable as principal for the actions of any person the secured party or assignee employs or contracts with to recover or take possession of the collateral after default as provided in section 4-9-609 in the same manner as if such person were the agent of the secured party or assignee, whether or not such person has been or may be deemed to be acting as an independent contractor in law.

(d) A repossessor shall not engage in repossessing, recovering, or removing collateral or personal property on behalf of a secured creditor or assignee without first disclosing to such secured creditor or assignee whether such repossessor is bonded pursuant to this article. Any person who fails to disclose or misrepresents to a secured party such person's bonded status or fails to file such bond with the attorney general shall be in violation of the "Colorado Consumer Protection Act", article 1 of title 6, C.R.S., and shall be subject to remedies or penalties or both pursuant to said article.

(e) Any person who knowingly falsifies a repossessor bond application or misrepresents information contained therein commits a class 1 misdemeanor and shall be punished as provided in section 18-1.3-501, C.R.S.

(f) All moneys collected by the attorney general pursuant to this section shall be transmitted to the state treasurer, who shall credit the same to the general fund.

(g) Notwithstanding any provision by contract or common law, in exercising its rights after default, a secured party or lessor taking possession of a motor vehicle may not disable or render unusable any computer program or other similar device embedded in the motor vehicle if immediate injury to any person or property is a reasonably foreseeable consequence of such action. Any secured party or lessor who disables or renders unusable such a computer program or other similar device in such circumstances shall be liable in accordance with applicable rules of law to any person who sustains an injury to person or property as a reasonably foreseeable result of the secured party's or lessor's action.

Source: L. 2001: Entire article R&RE, p. 1422, § 1, effective July 1. **L. 2002:** (g) added, p. 939, § 10, effective August 7; (e) amended, p. 1465, § 10, effective October 1.

Editor's note - Colorado legislative change: Colorado added this section.

Cross references: For the legislative declaration contained in the 2002 act amending subsection (e), see section 1 of chapter 318, Session Laws of Colorado 2002.

PART 7

TRANSITION

4-9-701. Effective date. This act takes effect on July 1, 2001. References in this part 7 to "this act" refer to the repealed and reenacted article 9 of this title as contained in Senate Bill 01-240, enacted at the first regular session of the sixty-third general assembly. References in this part 7 to "former article 9" are to article 9 of this title as in effect immediately before July 1, 2001.

Source: L. 2001: Entire article R&RE, p. 1423, § 1, effective July 1.

Editor's note - Colorado legislative change: The uniform act (e) states: "This act takes effect on July 1, 2001."

OFFICIAL COMMENT

A uniform law as complex as Article 9 necessarily gives rise to difficult problems and uncertainties during the transition to the new law. As is customary for uniform laws, this Article is based on the general assumption that all States will have enacted substantially identical versions. While always important, uniformity is essential to the success of this Article. If former Article 9 is in effect in some jurisdictions, and this Article is in effect in others, horrendous complications may arise. For example, the proper place in which to file to perfect a security interest (and thus the status of a particular security interest as perfected or unperfected) would depend on whether the matter was litigated in a State in which former Article 9 was in effect or a State in which this Article was in effect. Accordingly, this section contemplates that States will adopt a uniform effective date for this Article. Any one State's failure to adopt the uniform effective date will greatly increase the cost and uncertainty surrounding the transition.

Other problems arise from transactions and relationships that were entered into under former Article 9 or under non-UCC law and which remain outstanding on the effective date of this Article. The difficulties arise primarily because this Article expands the scope of former Article 9 to cover additional types of collateral and transactions and because it provides new methods of perfection for some types of collateral, different priority rules, and different choice-of-law rules governing perfection and priority. This Section and the other sections in this Part address primarily this second set of problems.

4-9-702. Savings clause. (a) Except as otherwise provided in this part 7, this act applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before July 1, 2001.

(b) Except as otherwise provided in subsection (c) of this section and sections 4-9-703 to 4-9-710:

(1) Transactions and liens that were not governed by former article 9, were validly entered into or created before July 1, 2001, and would be subject to this act if they had been entered into or created on or after July 1, 2001, and the rights, duties, and interests flowing from those transactions and liens remain valid on or after July 1, 2001; and

(2) The transactions and liens may be terminated, completed, consummated, and enforced as required or permitted by this act or by the law that otherwise would apply if this act had not taken effect.

(c) This act does not affect an action, case, or proceeding commenced before July 1, 2001.

Source: L. 2001: Entire article R&RE, p. 1423, § 1, effective July 1. **L. 2002:** IP(b) amended, p. 940, § 11, effective August 7.

OFFICIAL COMMENT

1. **Pre-Effective-Date Transactions.** Subsection (a) contains the general rule that this Article applies to transactions, security interests, and other liens within its scope (see Section 9-109), even if the transaction or lien was entered into or created before the effective date. Thus, secured transactions entered into under former Article 9 must be terminated, completed, consummated, and enforced under this Article. Subsection (b) is an exception to the general rule. It applies to valid, pre-effective-date transactions and liens that were not governed by former Article 9 but would be governed by this Article if they had been entered into or created after this Article takes effect. Under subsection (b), these valid transactions, such as the creation of agricultural liens and security interests in commercial tort claims, retain their validity under this Article and may be terminated, completed, consummated, and enforced under this Article. However, these transactions also may be terminated, completed, consummated, and enforced by the law that otherwise would apply had this Article not taken effect.

2. **Judicial Proceedings Commenced Before Effective Date.** As is usual in transition provisions, subsection (c) provides that this Article does not affect litigation pending on the effective date.

4-9-703. Security interest perfected before effective date. (a) A security interest that is enforceable immediately before July 1, 2001, and would have priority over the rights of a person that becomes a lien creditor at that time is a perfected security interest under this act if, on July 1, 2001, the applicable requirements for enforceability and perfection under this act are satisfied without further action.

(b) Except as otherwise provided in section 4-9-705, if, immediately before July 1, 2001, a security interest is enforceable and would have priority over the rights of a person that becomes a lien creditor at that time, but the applicable requirements for enforceability or perfection under this act are not satisfied on July 1, 2001, the security interest:

(1) Is a perfected security interest for one year after July 1, 2001;

(2) Remains enforceable after June 30, 2002, only if the security interest becomes enforceable under section 4-9-203 before July 1, 2002; and

(3) Remains perfected after June 30, 2002, only if the applicable requirements for perfection under this act are satisfied before July 1, 2002.

(c) Notwithstanding subsections (a) and (b) of this section, a lien, pledge, or security interest granted by a governmental unit prior to July 1, 2001, that is enforceable immediately before July 1, 2001, and that would have priority over the rights of a person that becomes a lien creditor at that time, shall remain enforceable and continue to have such priority on or after July 1, 2001.

Source: L. 2001: Entire article R&RE, p. 1423, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado added subsection (c).

OFFICIAL COMMENT

1. **Perfected Security Interests Under Former Article 9 and This Article.** This section deals with security interests that are perfected (i.e., that are enforceable and have priority over the rights of a lien creditor) under former Article 9 or other applicable law immediately before this Article takes effect. Subsection (a) provides, not surprisingly, that if the security interest would be a perfected security interest under this Article (i.e., if the transaction satisfies this Article's requirements for enforceability (attachment) and perfection), no further action need be taken for the security interest to be a perfected security interest.

2. **Security Interests Enforceable and Perfected Under Former Article 9 but Unenforceable or Unperfected Under This Article.** Subsection (b) deals with security interests that are enforceable and perfected under former Article 9 or other applicable law immediately before this Article takes effect but do not satisfy the requirements for enforceability (attachment) or perfection under this Article. Except as otherwise provided in Section 9-705, these security

interests are perfected security interests for one year after the effective date. If the security interest satisfies the requirements for attachment and perfection within that period, the security interest remains perfected thereafter. If the security interest satisfies only the requirements for attachment within that period, the security interest becomes unperfected at the end of the one-year period.

Example 1: A pre-effective-date security agreement in a consumer transaction covers "all securities accounts." The security interest is properly perfected. The collateral description was adequate under former Article 9 (see former Section 9-115(3)) but is insufficient under this Article (see Section 9-108(e)(2)). Unless the debtor authenticates a new security agreement describing the collateral other than by "type" (or Section 9-203(b)(3) otherwise is satisfied) within the one-year period following the effective date, the security interest becomes unenforceable at the end of that period.

Other examples under former Article 9 or other applicable law that may be effective as attachment or enforceability steps but may be ineffective under this Article include an oral agreement to sell a payment intangible or possession by virtue of a notification to a bailee under former Section 9-305. Neither the oral agreement nor the notification would satisfy the revised Section 9-203 requirements for attachment.

Example 2: A pre-effective-date possessory security interest in instruments is perfected by a bailee's receipt of notification under former 9-305. The bailee has not, however, acknowledged that it holds for the secured party's benefit under revised Section 9-313. Unless the bailee authenticates a record acknowledging that it holds for the secured party (or another appropriate perfection step is taken) within the one-year period following the effective date, the security interest becomes unperfected at the end of that period.

3. **Interpretation of Pre-Effective-Date Security Agreements.** Section 9-102 defines "security agreement" as "an agreement that creates or provides for a security interest." Under Section 1-201(3), an "agreement" is a "bargain of the parties in fact." If parties to a pre-effective-date security agreement describe the collateral by using a term defined in former Article 9 in one way and defined in this Article in another way, in most cases it should be presumed that the bargain of the parties contemplated the meaning of the term under former Article 9.

Example 3: A pre-effective-date security agreement covers "all accounts" of a debtor. As defined under former Article 9, an "account" did not include a right to payment for lottery winnings. These rights to payment are "accounts" under this Article, however. The agreement of the parties presumptively created a security interest in "accounts" as defined in former Article 9. A different result might be appropriate, for example, if the security agreement explicitly contemplated future changes in the Article 9 definitions of types of collateral e.g., "'Accounts' means 'accounts' as defined in the UCC Article 9 of [State X], *as that definition may be amended from time to time*." Whether a different approach is appropriate in any given case depends on the bargain of the parties, as determined by applying ordinary principles of contract construction.

4-9-704. Security interest unperfected before effective date. A security interest that is enforceable immediately before July 1, 2001, but that would be subordinate to the rights of a person that becomes a lien creditor at that time:

(1) Remains an enforceable security interest for one year after July 1, 2001;

(2) Remains enforceable after June 30, 2002, only if the security interest becomes enforceable under section 4-9-203 on or before June 30, 2002; and

(3) Becomes perfected:

(A) Without further action, on July 1, 2001, if the applicable requirements for perfection under this act are satisfied on or before July 1, 2001; or

(B) When the applicable requirements for perfection are satisfied if the requirements are satisfied after July 1, 2001.

Source: L. 2001: Entire article R&RE, p. 1424, § 1, effective July 1.

OFFICIAL COMMENT

This section deals with security interests that are enforceable but unperfected (i.e., subordinate to the rights of a person who becomes a lien creditor) under former Article 9 or other applicable law immediately before this Article takes effect. These security interests remain enforceable for one year after the effective date, and thereafter if the appropriate steps for attachment under this Article are taken before the one-year period expires. (This section's treatment of enforceability is the same as that of Section 9-703.) The security interest becomes a perfected security interest on the effective date if, at that time, the security interest satisfies the re-

quirements for perfection under this Article. If the security interest does not satisfy the requirements for perfection until sometime thereafter, it becomes a perfected security interest at that later time.

Example: A security interest has attached under former Article 9 but is unperfected because the filed financing statement covers "all of debtor's personal property" and controlling case law in the applicable jurisdiction has determined that this identification of collateral in a financing statement is insufficient. Upon the effective date of this Article, the financing statement becomes sufficient under Section 9-504(2). On that date the security interest becomes perfected. (This assumes, of course, that the financing statement is filed in the proper filing office under this Article.)

4-9-705. Effectiveness of action taken before effective date. (a) If action, other than the filing of a financing statement, is taken before July 1, 2001, and the action would have resulted in priority of a security interest over the rights of a person that becomes a lien creditor had the security interest become enforceable before July 1, 2001, the action is effective to perfect a security interest that attaches under this act on or before June 30, 2002. An attached security interest becomes unperfected on July 1, 2002, unless the security interest becomes a perfected security interest under this act on or before June 30, 2002.

(b) The filing of a financing statement before July 1, 2001, is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under this act.

(c) This act does not render ineffective an effective financing statement that, before July 1, 2001, is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in former section 4-9-103. However, except as otherwise provided in subsections (d) and (e) of this section and section 4-9-706, the financing statement ceases to be effective at the earlier of:

(1) The time the financing statement would have ceased to be effective under the law of the jurisdiction in which it is filed; or

(2) June 30, 2006.

(d) The filing of a continuation statement after July 1, 2001, does not continue the effectiveness of the financing statement filed before said date. However, upon the timely filing of a continuation statement after July 1, 2001, and in accordance with the law of the jurisdiction governing perfection as provided in part 3 of this article, the effectiveness of a financing statement filed in the same office in that jurisdiction before said date continues for the period provided by the law of that jurisdiction.

(e) Paragraph (2) of subsection (c) of this section applies to a financing statement that, before July 1, 2001, is filed against a transmitting utility and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in former section 4-9-103 only to the extent that part 3 of this article provides that the law of a jurisdiction other than the jurisdiction in which the financing statement is filed governs perfection of a security interest in collateral covered by the financing statement.

(f) A financing statement that includes a financing statement filed before July 1, 2001, and a continuation statement filed after said date is effective only to the extent that it satisfies the requirements of part 5 of this article for an initial financing statement.

Source: L. 2001: Entire article R&RE, p. 1424, § 1, effective July 1.

OFFICIAL COMMENT

1. **General.** This section addresses primarily the situation in which the perfection step is taken under former Article 9 or other applicable law before the effective date of this Article, but the security interest does not attach until after that date.

2. **Perfection Other Than by Filing.** Subsection (a) applies when the perfection step is a step other than the filing of a financing statement. If the step that would be a valid perfection step under former Article 9 or other law is taken before this Article takes effect, and if a security interest attaches within one year after this Article takes effect, then the security interest becomes a perfected security interest upon attachment. However, the security interest becomes unperfected one year after the effective date unless the requirements for attachment and perfection under this Article are satisfied within that period.

3. **Perfection by Filing: Ineffective Filings Made Effective.** Subsection (b) deals with fi-

nancing statements that were filed under former Article 9 and which would not have perfected a security interest under the former Article (because, e.g., they did not accurately describe the collateral or were filed in the wrong place), but which would perfect a security interest under this Article. Under subsection (b), such a financing statement is effective to perfect a security interest to the extent it complies with this Article. Subsection (b) applies regardless of the reason for the filing. For example, a secured party need not wait until the effective date to respond to the change this Article makes with respect to the jurisdiction whose law governs perfection of certain security interests. Rather, a secured party may wish to prepare for this change by filing a financing statement before the effective date in the jurisdiction whose law governs perfection under this Article. When this Article takes effect, the filing becomes effective to perfect a security interest (assuming the filing satisfies the perfection requirements of this Article). Note, however, that Section 9-706 determines whether a financing statement filed before the effective date operates to continue the effectiveness of a financing statement filed in another office before the effective date.

4. **Perfection by Filing: Change in Applicable Law or Filing Office.** Subsection (c) provides that a financing statement filed in the proper jurisdiction under former Section 9-103 remains effective for all purposes, despite the fact that this Article would require filing of a financing statement in a different jurisdiction or in a different office in the same jurisdiction. This means that, during the early years of this Article's effectiveness, it may be necessary to search not only in the filing office of the jurisdiction whose law governs perfection under this Article but also (if different) in the jurisdiction(s) and filing office(s) designated by former Article 9. To limit this burden, subsection (c) provides that a financing statement filed in the jurisdiction determined by former Section 9-103 becomes ineffective at the earlier of the time it would become ineffective under the law of that jurisdiction or June 30, 2006. The June 30, 2006, limitation addresses some nonuniform versions of former Article 9 that extended the effectiveness of a financing statement beyond five years. Note that a financing statement filed before the effective date may remain effective beyond June 30, 2006, if subsection (d) (concerning continuation statements) or (e) (concerning transmitting utilities) or Section 9-706 (concerning initial financing statements that operate to continue pre-effective-date financing statements) so provides.

Subsection (c) is an exception to Section 9-703(b). Under the general rule in Section 9-703(b), a security interest that is enforceable and perfected on the effective date of this Article is a perfected security interest for one year after this Article takes effect, even if the security interest is not enforceable under this Article and the applicable requirements for perfection under this Article have not been met. However, in some cases subsection (c) may shorten the one-year period of perfection; in others, if the security interest is enforceable under Section 9-203, it may extend the period of perfection.

Example 1: On July 3, 1996, D, a State X corporation, creates a security interest in certain manufacturing equipment located in State Y. On July 6, 1996, SP perfects a security interest in the equipment under former Article 9 by filing in the office of the State Y Secretary of State. See former Section 9-103(1)(b). This Article takes effect in States X and Y on July 1, 2001. Under Section 9-705(c), the financing statement remains effective until it lapses in July 2001. See former Section 9-403. Had SP continued the effectiveness of the financing statement by filing a continuation statement in State Y under former Article 9 before July 1, 2001, the financing statement would have remained effective to perfect the security interest through June 30, 2006. See subsection (c)(2). Alternatively, SP could have filed an initial financing statement in State X under subsection (b) or Section 9-706 before the State Y financing statement lapsed. Had SP done so, the security interest would have remained perfected without interruption until the State X financing statement lapsed.

5. **Continuing Effectiveness of Filed Financing Statement.** A financing statement filed before the effective date of this Article may be continued only by filing in the State and office designated by this Article. This result is accomplished in the following manner: Subsection (d) indicates that, as a general matter, a continuation statement filed after the effective date of this Article does not continue the effectiveness of a financing statement filed under the law designated by former Section 9-103. Instead, an initial financing statement must be filed under Section 9-706. The second sentence of subsection (d) contains an exception to the general rule. It provides that a continuation statement is effective to continue the effectiveness of a financing statement filed before this Article takes effect if this Article prescribes not only the same jurisdiction but also the same filing office.

Example 2: On November 8, 2000, D, a State X corporation, creates a security interest in certain manufacturing equipment located in State Y. On November 15, 2000, SP perfects a security interest in the equipment under former Article 9 by filing in office of the State Y Secretary of State. See former Section 9-103(1)(b). This Article takes effect in States X and Y on July 1, 2001. Under Section 9-705(c), the financing statement ceases to be effective in November, 2005, when it lapses. See Section 9-515. Under this Article, the law of D's location (State X, see Section 9-307) governs perfection. See Section

9-301. Thus, the filing of a continuation statement in State Y after the effective date would not continue the effectiveness of the financing statement. See subsection (d). However, the effectiveness of the financing statement could be continued under Section 9-706.

Example 3: The facts are as in Example 2, except that D is a State Y corporation. Assume State Y adopted former Section 9-401(1) (second alternative). State Y law governs perfection under Part 3 of this Article. (See Sections 9-301, 9-307.) Under the second sentence of subsection (d), the timely filing of a continuation statement in accordance with the law of State Y continues the effectiveness of the financing statement.

Example 4: The facts are as in Example 3, except that the collateral is equipment used in farming operations and, in accordance with former Section 9-401(1) (second alternative) as enacted in State Y, the financing statement was filed in State Y, in the office of the Shelby County Recorder of Deeds. Under this Article, a continuation statement must be filed in the office of the State Y Secretary of State. See Section 9-501(a)(2). Under the second sentence of subsection (d), the timely filing of a continuation statement in accordance with the law of State Y operates to continue a pre-effective-date financing statement only if the continuation statement is filed in the same office as the financing statement. Accordingly, the continuation statement is not effective in this case, but the financing statement may be continued under Section 9-706.

Example 5: The facts are as in Example 3, except that State Y enacted former Section 9-401(1) (third alternative). As required by former Section 9-401(1), SP filed financing statements in both the office of the State Y Secretary of State and the office of the Shelby County Recorder of Deeds. Under this Article, a continuation statement must be filed in the office of the State Y Secretary of State. See Section 9-501(a)(2). The timely filing of a continuation statement in that office after this Article takes effect would be effective to continue the effectiveness of the financing statement (and thus continue the perfection of the security interest), even if the financing statement filed with the County Recorder lapses.

6. **Continuation Statements.** In some cases, this Article reclassifies collateral covered by a financing statement filed under former Article 9. For example, collateral consisting of the right to payment for real property sold would be a "general intangible" under the former Article but an "account" under this Article. To continue perfection under those circumstances, a continuation statement must comply with the normal requirements for a continuation statement. See Section 9-515. In addition, the pre-effective-date financing statement and continuation statement, taken together, must satisfy the requirements of this Article concerning the sufficiency of the debtor's name, secured party's name, and indication of collateral. See subsection (f).

Example 6: A pre-effective-date financing statement covers "all general intangibles" of a debtor. As defined under former Article 9, a "general intangible," would include rights to payment for lottery winnings. These rights to payment are "accounts" under this Article, however. A post-effective-date continuation statement will not continue the effectiveness of the pre-effective-date financing statement with respect to lottery winnings unless it amends the indication of collateral covered to include lottery winnings (e.g., by adding "accounts," "rights to payment for lottery winnings," or the like). If the continuation statement does not amend the indication of collateral, the continuation statement will be effective to continue the effectiveness of the financing statement only with respect to "general intangibles" as defined in this Article.

Example 7: The facts are as in Example 6, except that the pre-effective-date financing statement covers "all accounts and general intangibles." Even though rights to payment for lottery winnings are "general intangibles" under former Article 9 and "accounts" under this Article, a post-effective-date continuation statement would continue the effectiveness of the pre-effective-date financing statement with respect to lottery winnings. There would be no need to amend the indication of collateral covered, inasmuch as the indication ("accounts") satisfies the requirements of this Article.

4-9-706. When initial financing statement suffices to continue effectiveness of financing statement. (a) The filing of an initial financing statement in the office specified in section 4-9-501 continues the effectiveness of a financing statement filed before July 1, 2001, if:

(1) The filing of an initial financing statement in that office would be effective to perfect a security interest under this act;

(2) The pre-effective-date financing statement was filed in an office in another state, another office in this state, or in the office of any clerk and recorder in this state; and

(3) The initial financing statement satisfies subsection (c) of this section.

(b) The filing of an initial financing statement under subsection (a) of this section continues the effectiveness of the pre-effective-date financing statement:

(1) If the initial financing statement is filed before July 1, 2001, for the period provided in former section 4-9-403 with respect to a financing statement; and

(2) If the initial financing statement is filed after July 1, 2001, for the period provided in section 4-9-515 with respect to an initial financing statement.

(c) To be effective for purposes of subsection (a) of this section, an initial financing statement must:

(1) Satisfy the requirements of part 5 of this article for an initial financing statement;

(2) Identify the pre-effective-date financing statement by indicating the office in which the financing statement was filed and providing the dates of filing and file numbers, if any, of the financing statement and of the most recent continuation statement filed with respect to the financing statement; and

(3) Indicate that the pre-effective-date financing statement remains effective.

Source: L. 2001: Entire article R&RE, p. 1425, § 1, effective July 1. **L. 2002:** (a)(2) amended, p. 940, § 12, effective August 7.

OFFICIAL COMMENT

1. **Continuation of Financing Statements Not Filed in Proper Filing Office Under This Article.** This section deals with continuing the effectiveness of financing statements that are filed in the proper State and office under former Article 9, but which would be filed in the wrong State or in the wrong office of the proper State under this Article. Section 9-705(d) provides that, under these circumstances, filing a continuation statement after the effective date of this Article in the office designated by former Article 9 would not be effective. This section provides the means by which the effectiveness of such a financing statement can be continued if this Article governs perfection under the applicable choice-of-law rule: filing an initial financing statement in the office specified by Section 9-501.

Although it has the effect of continuing the effectiveness of a pre-effective-date financing statement, an initial financing statement described in this section is not a continuation statement. Rather, it is governed by the rules applicable to initial financing statements. (However, the debtor need not authorize the filing. See Section 9-708.) Unlike a continuation statement, the initial financing statement described in this section may be filed any time during the effectiveness of the pre-effective-date financing statement even before this Article is enacted and not only within the six months immediately prior to lapse. In contrast to a continuation statement, which extends the lapse date of a filed financing statement for five years, the initial financing statement has its own lapse date, which bears no relation to the lapse date of the pre-effective-date financing statement whose effectiveness the initial financing statement continues. See subsection (b).

As subsection (a) makes clear, the filing of an initial financing statement under this section *continues* the effectiveness of a pre-effective-date financing statement. If the effectiveness of a pre-effective-date financing statement lapses before the initial financing statement is filed, the effectiveness of the pre-effective-date financing statement cannot be continued. Rather, unless the security interest is perfected otherwise, there will be a period during which the security interest is unperfected before becoming perfected again by the filing of the initial financing statement under this section.

If an initial financing statement is filed under this section before the effective date of this Article, it takes effect when this Article takes effect (assuming that it is ineffective under former Article 9). Note, however, that former Article 9 determines whether the filing office is obligated to accept such an initial financing statement. For the reason given in the preceding paragraph, an initial financing statement filed before the effective date of this Article does not continue the effectiveness of a pre-effective-date financing statement unless the latter remains effective on the effective date of this Article. Thus, for example, if the effectiveness of the pre-effective-date financing statement lapses before this Article takes effect, the initial financing statement would not continue its effectiveness.

2. **Requirements of Initial Financing Statement Filed in Lieu of Continuation Statement.** Subsection (c) sets forth the requirements for the initial financing statement under subsection (a). These requirements are needed to inform searchers that the initial financing statement operates to continue a financing statement filed elsewhere and to enable searchers to locate and discover the attributes of the other financing statement. [The notice-filing policy of this Article applies to the initial financing statements described in this section. Accordingly, an initial financing statement that substantially satisfies the requirements of subsection (c) is effective, even if it has minor errors or omissions, unless the errors or omissions make the financing statement seriously misleading. See Section 9-506.]

Note: The bracketed language takes effect July 1, 2013.

A single initial financing statement may continue the effectiveness of more than one financing statement filed before this Article's effective date. See Section 1-102(5)(a) (words in the singular include the plural). If a financing statement has been filed in more than one office in a given jurisdiction, as may be the case if the jurisdiction had adopted former Section 9-401(1), third alternative, then an identification of the filing in the central filing office suffices for purposes of subsection (c)(2). If under this Article the collateral is of a type different from its type under former Article 9 as would be the case, e.g., with a right to payment of lottery winnings (a "general intangible" under former Article 9 and an "account" under this Article), then subsection (c) requires that the initial financing statement indicate the type under this Article.

Note:"1-102(5)(a)" will be replaced with "1-106" effective July 1, 2013.

4-9-707. Amendment of pre-effective-date financing statement. (a) As used in this part 7, "pre-effective-date financing statement" means a financing statement filed before July 1, 2001.

(b) After July 1, 2001, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or otherwise amend the information provided in, a pre-effective-date financing statement only in accordance with the law of the jurisdiction governing perfection as provided in part 3 of this article. However, the effectiveness of a pre-effective-date financing statement also may be terminated in accordance with the law of the jurisdiction in which the financing statement is filed.

(c) Except as otherwise provided in subsection (d) of this section, if the law of this state governs perfection of a security interest, the information in a pre-effective-date financing statement may be amended after July 1, 2001, only if:

(1) The pre-effective-date financing statement and an amendment are filed in the office specified in section 4-9-501;

(2) An amendment is filed in the office specified in section 4-9-501 concurrently with, or after the filing in that office of, an initial financing statement that satisfies section 4-9-706 (c); or

(3) An initial financing statement that provides the information as amended and satisfies section 4-9-706 (c) is filed in the office specified in section 4-9-501.

(d) If the law of this state governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement may be continued only under section 4-9-705 (d) and (f) or 4-9-706.

(e) Whether or not the law of this state governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement filed in this state may be terminated after July 1, 2001, by filing a termination statement in the office in which the pre-effective date financing statement is filed, unless an initial financing statement that satisfies section 4-9-706 (c) has been filed in the office specified by the law of the jurisdiction governing perfection as provided in part 3 of this article as the office in which to file a financing statement.

Source: L. 2001: Entire article R&RE, p. 1426, § 1, effective July 1.

Editor's note - Colorado legislative change: Colorado added this section; the uniform act's section 707 is codified at section 4-9-708.

OFFICIAL COMMENT

1. **Scope of This Section.** This section addresses post-effective-date amendments to pre-effective-date financing statements.

2. **Applicable Law.** Determining how to amend a pre-effective-date financing statement requires one first to determine the jurisdiction whose law applies. Subsection (b) provides that, as a general matter, post-effective-date amendments to pre-effective-date financing statements are effective only if they are accomplished in accordance with the substantive (or local) law of the jurisdiction governing perfection under Part 3 of this Article. However, under certain circumstances, the effectiveness of a financing statement may be terminated in accordance with the substantive law of the jurisdiction in which the financing statement is filed. See Comment 5, below.

Example 1: D is a corporation organized under the law of State Y. It owns equipment

located in State X. Under former Article 9, SP properly perfected a security interest in the equipment by filing a financing statement in State X. Under this Article, the law of State Y governs perfection of the security interest. See Sections 9-301, 9-307. After this Article takes effect, SP wishes to amend the financing statement to reflect a change in D's name. Under subsection (b), the financing statement may be amended in accordance with the law of State Y, i.e., in accordance with subsection (c) as enacted in State Y.

Example 2: The facts are as in Example 1, except that SP wishes to terminate the effectiveness of the State X filing. The first sentence of subsection (b) provides that the financing statement may be terminated after the effective date of this Article in accordance with the law of State Y, i.e., in accordance with subsection (c) as enacted in State Y. However, the second sentence provides that the financing statement also may be terminated in accordance with the law of the jurisdiction in which it is filed, i.e., in accordance with subsection (e) as enacted in State X. If the pre-effective-date financing statement is filed in the jurisdiction whose law governs perfection (here, State Y), then both sentences would designate the law of State Y as applicable to the termination of the financing statement. That is, the financing statement could be terminated in accordance with subsection (c) or (e) as enacted in State Y.

3. **Method of Amending.** Subsection (c) provides three methods of effectuating a post-effective-date amendment to a pre-effective-date financing statement. Under subsection (c)(1), if the financing statement is filed in the jurisdiction and office determined by this Article, then an effective amendment may be filed in the same office.

Example 3: D is a corporation organized under the law of State Z. It owns equipment located in State Z. Before the effective date of this Article, SP perfected a security interest in the equipment by filing in two offices in State Z, a local filing office and the office of the Secretary of State. See former Section 9-401(1) (third alternative). State Z enacts this Article and specifies in Section 9-501 that a financing statement covering equipment is to be filed in the office of the Secretary of State. SP wishes to assign its power as secured party of record. Under subsection (b), the substantive law of State Z applies. Because the pre-effective-date financing statement is filed in the office specified in subsection (c)(1) as enacted by State Z, SP may effectuate the assignment by filing an amendment under Section 9-514 with the office of the Secretary of State. SP need not amend the local filing, and the priority of the security interest perfected by the filing of the financing statement would not be affected by the failure to amend the local filing.

If a pre-effective-date financing statement is filed in an office other than the one specified by Section 9-501 of the relevant jurisdiction, then ordinarily an amendment filed in that office is ineffective. (Subsection (e) provides an exception for termination statements.) Rather, the amendment must be effectuated by a filing in the jurisdiction and office determined by this Article. That filing may consist of an initial financing statement followed by an amendment, an initial financing statement together with an amendment, or an initial financing statement that indicates the information provided in the financing statement, as amended. Subsection (c)(2) encompasses the first two options; subsection (c)(3) contemplates the last. In each instance, the initial financing statement must satisfy Section 9-706(c).

4. **Continuation.** Subsection (d) refers to the two methods by which a secured party may continue the effectiveness of a pre-effective-date financing statement under this Part. The Comments to Sections 9-705 and 9-706 explain these methods.

5. **Termination.** The effectiveness of a pre-effective-date financing statement may be terminated pursuant to subsection (c). This section also provides an alternative method for accomplishing this result: filing a termination statement in the office in which the financing statement is filed. The alternative method becomes unavailable once an initial financing statement that relates to the pre-effective-date financing statement and satisfies Section 9-706(c) is filed in the jurisdiction and office determined by this Article.

Example 4: The facts are as in Example 1, except that SP wishes to terminate a financing statement filed in State X. As explained in Example 1, the financing statement may be amended in accordance with the law of the jurisdiction governing perfection under this Article, i.e., in accordance with the substantive law of State Y. As enacted in State Y, subsection (c)(1) is inapplicable because the financing statement was not filed in the State Y filing office specified in Section 9-501. Under subsection (c)(2), the financing statement may be amended by filing in the State Y filing office an initial financing statement followed by a termination statement. The filing of an initial financing statement together with a termination statement also would be legally sufficient under subsection (c)(2), but Section 9-512(a)(1) may render this method impractical. The financing statement also may be amended under subsection (c)(3), but the resulting initial financing statement is likely to be very confusing. In each instance, the initial financing statement must satisfy Section 9-706(c). Applying the law of State Y, subsection (e) is inapplicable, because the financing statement was not filed in "this State," i.e., State Y.

This section affords another option to SP. Subsection (b) provides that the effectiveness of a financing statement may be terminated either in accordance with the law of the jurisdiction governing perfection (here, State Y) or in accordance with the substantive law of the jurisdiction in which the financing statement is filed (here, State X). Applying the law of State X, the financing statement is filed in "this State," i.e., State X, and subsection (e) applies. Accordingly, the effectiveness of the financing statement can be terminated by filing a termination statement in the State X office in which the financing statement is filed, unless an initial financing statement that relates to the financing statement and satisfies Section 9-706(c) as enacted in State X has been filed in the jurisdiction and office determined by this Article (here, the State Y filing office).

4-9-708. Persons entitled to file initial financing statement or continuation statement. A person may file an initial financing statement or a continuation statement under this part 7 if:

(1) The secured party of record authorizes the filing; and

(2) The filing is necessary under this part 7:

(A) To continue the effectiveness of a financing statement filed before July 1, 2001; or

(B) To perfect or continue the perfection of a security interest.

Source: L. 2001: Entire article R&RE, p. 1427, § 1, effective July 1.

Editor's note - Colorado legislative change: The uniform act codified this section as section 707.

OFFICIAL COMMENT

This section permits a secured party to file an initial financing statement or continuation statement necessary under this Part to continue the effectiveness of a financing statement filed before this Article takes effect or to perfect or otherwise continue the perfection of a security interest. Because a filing described in this section typically operates to continue the effectiveness of a financing statement whose filing the debtor already has authorized, this section does not require authorization from the debtor.

4-9-709. Priority. (a) This act determines the priority of conflicting claims to collateral. However, if the relative priorities of the claims were established before July 1, 2001, former article 9 determines priority.

(b) For purposes of section 4-9-322 (a), the priority of a security interest that becomes enforceable under section 4-9-203 of this act dates from July 1, 2001, if the security interest is perfected under this act by the filing of a financing statement before said date which would not have been effective to perfect the security interest under former article 9. This subsection (b) does not apply to conflicting security interests each of which is perfected by the filing of such a financing statement.

Source: L. 2001: Entire article R&RE, p. 1427, § 1, effective July 1.

Editor's note - Colorado legislative change: The uniform act codified this section as section 708.

OFFICIAL COMMENT

1. **Law Governing Priority.** Ordinarily, this Article determines the priority of conflicting claims to collateral. However, when the relative priorities of the claims were established before this Article takes effect, former Article 9 governs.

Example 1: In 1999, SP-1 obtains a security interest in a right to payment for goods sold ("account"). SP-1 fails to file a financing statement. This Article takes effect on July 1, 2001. Thereafter, on August 1, 2001, D creates a security interest in the same account in favor of SP-2, who files a financing statement. This Article determines the relative priorities of the claims. SP-2's security interest has priority under Section 9-322(a)(1).

Example 2: In 1999, SP-1 obtains a security interest in a right to payment for goods sold ("account"). SP-1 fails to file a financing statement. In 2000, D creates a security interest in

the same account in favor of SP-2, who likewise fails to file a financing statement. This Article takes effect on July 1, 2001. Because the relative priorities of the security interests were established before the effective date of this Article, former Article 9 governs priority, and SP-1's security interest has priority under former Section 9-312(5)(b).

Example 3: The facts are as in Example 2, except that, on August 1, 2001, SP-2 files a proper financing statement under this Article. Until August 1, 2001, the relative priorities of the security interests were established before the effective date of this Article, as in Example 2. However, by taking the affirmative step of filing a financing statement, SP-2 established anew the relative priority of the conflicting claims after the effective date. Thus, this Article determines priority. SP-2's security interest has priority under Section 9-322(a)(1).

As Example 3 illustrates, relative priorities that are "established" before the effective date do not necessarily remain unchanged following the effective date. Of course, unlike priority contests among unperfected security interests, some priorities are established permanently, e.g., the rights of a buyer of property who took free of a security interest under former Article 9.

One consequence of the rule in subsection (a) is that the mere taking effect of this Article does not of itself adversely affect the priority of conflicting claims to collateral.

Example 4: In 1999, SP-1 obtains a security interest in a right to payment for lottery winnings (a "general intangible" as defined in former Article 9 but an "account" as defined in this Article). SP-1's security interest is unperfected because its filed financing statement covers only "accounts." In 2000, D creates a security interest in the same right to payment in favor of SP-2, who files a financing statement covering "accounts and general intangibles." Before this Article takes effect on July 1, 2001, SP-2's perfected security interest has priority over SP-1's unperfected security interest under former 9-312(5). Because the relative priorities of the security interests were established before the effective date of this Article, former Article 9 continues to govern priority after this Article takes effect. Thus, SP-2's priority is not adversely affected by this Article's having taken effect.

Note that were this Article to govern priority, SP-2 would become subordinated to SP-1 under Section 9-322(a)(1), even though nothing changes other than this Article's having taken effect. Under Section 9-704, SP-1's security interest would become perfected; the financing statement covering "accounts" adequately covers the lottery winnings and complies with the other perfection requirements of this Article, e.g., it is filed in the proper office.

Example 5: In 1999, SP-1 obtains a security interest in a right to payment for lottery winnings a "general intangible" (as defined under former Article 9). SP-1's security interest is unperfected because its filed financing statement covers only "accounts." In 2000, D creates a security interest in the same right to payment in favor of SP-2, who makes the same mistake and also files a financing statement covering only "accounts." Before this Article takes effect on July 1, 2001, SP-1's unperfected security interest has priority over SP-2's unperfected security interest, because SP-1's security interest was the first to attach. See former Section 9-312(5)(b). Because the relative priorities of the security interests were established before the effective date of this Article, former Article 9 continues to govern priority after this Article takes effect. Although Section 9-704 makes both security interests perfected for purposes of this Article, both are unperfected under former Article 9, which determines their relative priorities.

2. **Financing Statements Ineffective Under Former Article 9 but Effective Under This Article.** If this Article determines priority, subsection (b) may apply. It deals with the case in which a filing that occurs before the effective date of this Article would be ineffective to perfect a security interest under former Article 9 but effective under this Article. For purposes of Section 9-322(a), the priority of a security interest that attaches after this Article takes effect and is perfected in this manner dates from the time this Article takes effect.

Example 6: In 1999, SP-1 obtains a security interest in D's existing and after-acquired instruments and files a financing statement covering "instruments." In 2000, D grants a security interest in its existing and after-acquired accounts in favor of SP-2, who files a financing statement covering "accounts." After this Article takes effect on July 1, 2001, one of D's account debtors gives D a negotiable note to evidence its obligation to pay an overdue account. Under the first-to-file-or-perfect rule in Section 9-322(a), SP-1 would have priority in the instrument, which constitutes SP-2's proceeds. SP-1's filing in 1999 was earlier than SP-2's in 2000. However, subsection (b) provides that, for purposes of Section 9-322(a), SP-1's priority dates from the time this Article takes effect (July 1, 2001). Under Section 9-322(b), SP-2's priority with respect to the proceeds (instrument) dates from its filing as to the original collateral (accounts). Accordingly, SP-2's security interest would be senior.

Subsection (b) does not apply to conflicting security interests each of which is perfected by a pre-effective-date filing that was not effective under former Article 9 but is effective under this Article.

Example 7: In 1999, SP-1 obtains a security interest in D's existing and after-acquired instru-

ments and files a financing statement covering "instruments." In 2000, D grants a security interest in its existing and after-acquired instruments in favor of SP-2, who files a financing statement covering "instruments." After this Article takes effect on July 1, 2001, one of D's account debtors gives D a negotiable note to evidence its obligation to pay an overdue account. Under the first-to-file-or-perfect rule in Section 9-322(a), SP-1 would have priority in the instrument. Both filings are effective under this Article, see Section 9-705(b), and SP-1's filing in 1999 was earlier than SP-2's in 2000. Subsection (b) does not change this result.

4-9-710. Effectiveness of filing in clerk and recorders' offices. Except as provided in this section, a pre-effective-date financing statement filed with respect to a security interest in the office of any clerk and recorder in this state shall be treated as if it had been filed in the office of the secretary of state. The preceding sentence does not apply to a financing statement to the extent that the financing statement:

(1) Covers timber to be cut or as-extracted collateral; or

(2) Was filed as a fixture filing.

Source: L. 2002: Entire section added, p. 940, § 13, effective August 7.

PART 8

TRANSITION PROVISIONS FOR 2010 AMENDMENTS

4-9-801. Effective date. House Bill 12-1262, enacted in 2012, takes effect on July 1, 2013.

Editor's note: This section is effective July 1, 2013.

Source: L. 2012: Entire part added, (HB 12-1262), ch. 170, p. 604, § 16, effective July 1, 2013.

OFFICIAL COMMENT

[These transition provisions largely track the provisions of Part 7, which govern the transition to the 1998 revision of this Article. The Comments to the sections of Part 7 generally are relevant to the corresponding sections of Part 8. The 2010 amendments are less far-reaching than the 1998 revision. Although Part 8 does not carry forward those Part 7 provisions that clearly would have no application to the transition to the amendments, as a matter of prudence Part 8 does carry forward all Part 7 provisions that are even arguably relevant to the transition.]

[The most significant transition problem raised by the 2010 amendments arises from changes to Section 9-503(a), concerning the name of the debtor that must be provided for a financing statement to be sufficient. Sections 9-805 and 9-806 address this problem.]

[Example: On November 8, 2012, Debtor, an individual whose"individual name" is "Lon Debtor" and whose principal residence is located in State A, creates a security interest in certain manufacturing equipment. On November 15, 2012, SP perfects a security interest in the equipment under Article 9 (as in effect prior to the 2010 amendments) by filing a financing statement against "Lon Debtor" in the State A filing office. On July 1, 2013, the 2010 amendments, including Alternative A to Section 9-503(a), take effect in State A. Debtor's unexpired State A driver's indicates that Debtor's name is "Polonius Debtor." Assuming that a search under "Polonius Debtor" using the filing office's standard search logic would not disclose the filed financing statement, the financing statement would be insufficient under amended Section 9-503(a)(4) (Alt. A). However, Section 9-805(b) provides that the 2010 amendments do not render the financing statement ineffective. Rather, the financing statement remains effective — even if it has become seriously misleading — until it would have ceased to be effective had the amendments not taken effect. See Section 9-805(b)(1). SP can continue the effectiveness of the financing statement by filing a continuation statement with the State A filing office. To do so, however, SP must amend Debtor's name on the financing statement to provide the name that is sufficient under Section 9-503(a)(4) (Alt. A) at the time the continuation statement is filed. See Section 9-805(c), (e).]

[The most significant transition problem addressed by the 1998 revision arose from the change in the choice-of-law rules governing where to file a financing statement. The 2010 amendments do not change the choice-of-law

rules. Even so, the amendments will change the place to file in a few cases, because certain entities that were not previously classified as "registered organizations" would fall within that category under the amendments.]

Note: The bracketed language takes effect July 1, 2013.

4-9-802. Savings clause. (a) Except as otherwise provided in this part 8, House Bill 12-1262, enacted in 2012, applies to a transaction or lien within its scope even if the transaction or lien was entered into or created before July 1, 2013.

(b) House Bill 12-1262, enacted in 2012, does not affect an action, case, or proceeding commenced before July 1, 2013.

Editor's note: This section is effective July 1, 2013.

Source: L. 2012: Entire part added, (HB 12-1262), ch. 170, p. 605, § 16, effective July 1, 2013.

4-9-803. Security interest perfected before effective date. (a) A security interest that is a perfected security interest immediately before July 1, 2013, is a perfected security interest under this article, as amended, if, when House Bill 12-1262, enacted in 2012, takes effect, the applicable requirements for attachment and perfection under this article, as amended by House Bill 12-1262, enacted in 2012, are satisfied without further action.

(b) Except as otherwise provided in section 4-9-805, which controls with respect to security interests perfected by the filing of a financing statement pursuant to part 5 of this article as it existed before July 1, 2013, if, immediately before July 1, 2013, a security interest is a perfected security interest but the applicable requirements for perfection under this article, as amended by House Bill 12-1262, enacted in 2012, are not satisfied by July 1, 2013, the security interest remains perfected thereafter only if the applicable requirements for perfection under this article, as amended by House Bill 12-1262, enacted in 2012, are satisfied within one year after July 1, 2013.

Editor's note: This section is effective July 1, 2013.

Source: L. 2012: Entire part added, (HB 12-1262), ch. 170, p. 605, § 16, effective July 1, 2013.

4-9-804. Security interest unperfected before effective date. (a) A security interest that is an unperfected security interest immediately before July 1, 2013, becomes a perfected security interest:

(1) Without further action, on July 1, 2013, if the applicable requirements for perfection under this article, as amended by House Bill 12-1262, enacted in 2012, are satisfied on or before July 1, 2013; or

(2) When the applicable requirements for perfection are satisfied if the requirements are satisfied after July 1, 2013.

Editor's note: This section is effective July 1, 2013.

Source: L. 2012: Entire part added, (HB 12-1262), ch. 170, p. 605, § 16, effective July 1, 2013.

4-9-805. Effectiveness of action taken before effective date. (a) The filing of a financing statement before July 1, 2013, is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under this article, as amended by House Bill 12-1262, enacted in 2012.

(b) House Bill 12-1262, enacted in 2012, does not render seriously misleading or otherwise ineffective an effective financing statement that, before July 1, 2013, was filed and satisfied the applicable requirements for perfection under the law of the jurisdiction

governing perfection as provided in this article as it existed before July 1, 2013. However, except as otherwise provided in subsections (c) and (d) of this section and section 4-9-806, the financing statement ceases to be effective:

(1) If the financing statement was filed in this state, at the time the financing statement would have ceased to be effective had House Bill 12-1262, enacted in 2012, not taken effect; or

(2) If the financing statement was filed in another jurisdiction, at the earlier of:

(A) The time the financing statement would have ceased to be effective under the law of that jurisdiction; or

(B) June 30, 2018.

(c) The timely filing of a continuation statement on or after July 1, 2013, in accordance with the law of the jurisdiction governing perfection as provided in this article, as amended by House Bill 12-1262, enacted in 2012, continues the effectiveness of a financing statement filed in the same office in that jurisdiction before July 1, 2013, for the period provided by the law of that jurisdiction, but only to the extent the financing statement, including any amendment filed before or, if permitted by the rules of the filing office, as part of, the continuation statement, satisfies the requirements of part 5 of this article, as amended by House Bill 12-1262, enacted in 2012, for an initial financing statement. Except as provided in the preceding sentence, the filing of a continuation statement on or after July 1, 2013, does not continue the effectiveness of a financing statement filed before July 1, 2013.

(d) Subparagraph (B) of paragraph (2) of subsection (b) of this section applies to a financing statement that, before July 1, 2013, is filed against a transmitting utility and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in this article as it existed before July 1, 2013, only to the extent that this article, as amended by House Bill 12-1262, enacted in 2012, provides that the law of a jurisdiction other than the jurisdiction in which the financing statement is filed governs perfection of a security interest in collateral covered by the financing statement.

(e) A financing statement that includes both a financing statement filed before July 1, 2013, and a continuation statement filed on or after July 1, 2013, is effective only to the extent that, after giving effect to any amendment filed before or, if permitted by the rules of the filing office, as part of, the continuation statement, the financing statement satisfies the requirements of part 5 of this article, as amended by House Bill 12-1262, enacted in 2012, for an initial financing statement. A financing statement filed before July 1, 2013, that indicates that the debtor is a decedent's estate indicates that the collateral is being administered by a personal representative within the meaning of section 4-9-503 (a) (2), as amended by House Bill 12-1262, enacted in 2012. A financing statement filed before July 1, 2013, that indicates that the debtor is a trust or is a trustee acting with respect to property held in trust indicates that the collateral is held in a trust within the meaning of section 4-9-503 (a) (3), as amended by House Bill 12-1262, enacted in 2012.

Editor's note: This section is effective July 1, 2013.

Source: L. 2012: Entire part added, (HB 12-1262), ch. 170, p. 605, § 16, effective July 1, 2013.

4-9-806. When initial financing statement suffices to continue effectiveness of financing statement. (a) The filing of an initial financing statement in the office specified in section 4-9-501 continues the effectiveness of a financing statement filed before July 1, 2013, if:

(1) The filing of an initial financing statement in that office would be effective to perfect a security interest under this article, as amended by House Bill 12-1262, enacted in 2012;

(2) The pre-effective-date financing statement was filed in an office in another state; and

(3) The initial financing statement satisfies subsection (c) of this section.

(b) The filing of an initial financing statement under subsection (a) of this section continues the effectiveness of the pre-effective-date financing statement:

(1) If the initial financing statement is filed before July 1, 2013, for the period provided in section 4-9-515, as it existed before July 1, 2013, with respect to an initial financing statement; and

(2) If the initial financing statement is filed after July 1, 2013, for the period provided in section 4-9-515, as amended by House Bill 12-1262, enacted in 2012, with respect to an initial financing statement.

(c) To be effective for purposes of subsection (a) of this section, an initial financing statement must:

(1) Satisfy the requirements of part 5 of this article, as amended by House Bill 12-1262, enacted in 2012, for an initial financing statement;

(2) Identify the pre-effective-date financing statement by indicating the office in which the financing statement was filed and providing the dates of filing and file numbers, if any, of the financing statement and of the most recent continuation statement filed with respect to the financing statement; and

(3) Indicate that the pre-effective-date financing statement remains effective.

Editor's note: This section is effective July 1, 2013.

Source: L. 2012: Entire part added, (HB 12-1262), ch. 170, p. 607, § 16, effective July 1, 2013.

4-9-807. Amendment of pre-effective-date financing statement. (a) In this section, "pre-effective-date financing statement" means a financing statement filed before July 1, 2013.

(b) On or after July 1, 2013, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or otherwise amend the information provided in, a pre-effective-date financing statement only in accordance with the law of the jurisdiction governing perfection as provided in this article, as amended by House Bill 12-1262, enacted in 2012. However, the effectiveness of a pre-effective-date financing statement also may be terminated in accordance with the law of the jurisdiction in which the financing statement is filed.

(c) Except as otherwise provided in subsection (d) of this section, if the law of this state governs perfection of a security interest, the information in a pre-effective-date financing statement may be amended on or after July 1, 2013, only if:

(1) The pre-effective-date financing statement and an amendment are filed in the office specified in section 4-9-501;

(2) An amendment is filed in the office specified in section 4-9-501 concurrently with, or after the filing in that office of, an initial financing statement that satisfies section 4-9-806 (c); or

(3) An initial financing statement that provides the information as amended and satisfies section 4-9-806 (c) is filed in the office specified in section 4-9-501.

(d) If the law of this state governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement may be continued only under section 4-9-805 (c) and (e) or 4-9-806.

(e) Whether or not the law of this state governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement filed in this state may be terminated after July 1, 2013, by filing a termination statement in the office in which the pre-effective-date financing statement is filed, unless an initial financing statement that satisfies section 4-9-806 (c) has been filed in the office specified by the law of the jurisdiction governing perfection as provided in this article, as amended by House Bill 12-1262, enacted in 2012, as the office in which to file a financing statement.

Editor's note: This section is effective July 1, 2013.

Source: L. 2012: Entire part added, (HB 12-1262), ch. 170, p. 607, § 16, effective July 1, 2013.

4-9-808. Person entitled to file initial financing statement or continuation statement. (a) A person may file an initial financing statement or a continuation statement under this part 8 if:

(1) The secured party of record authorizes the filing; and

(2) The filing is necessary under this part 8:

(A) To continue the effectiveness of a financing statement filed before July 1, 2013; or

(B) To perfect or continue the perfection of a security interest.

Editor's note: This section is effective July 1, 2013.

Source: L. 2012: Entire part added, (HB 12-1262), ch. 170, p. 608, § 16, effective July 1, 2013.

4-9-809. Priority. House Bill 12-1262, enacted in 2012, determines the priority of conflicting claims to collateral. However, if the relative priorities of the claims were established before July 1, 2013, this article, as it existed before July 1, 2013, determines priority.

Editor's note: This section is effective July 1, 2013.

Source: L. 2012: Entire part added, (HB 12-1262), ch. 170, p. 609, § 16, effective July 1, 2013.

ARTICLE 9.3

Central Information System

4-9.3-101 to 4-9.3-108. (Repealed)

Source: L. 2003: Entire article repealed, p. 1669, § 1, effective July 1.

Editor's note: This article was added in 1995. For amendments to this article prior to its repeal in 2003, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

ARTICLE 9.5

Central Filing of Effective Financing Statements

Editor's note: (1) Section 5 of chapter 40, Session Laws of Colorado 1988, provides that the act enacting this article is effective May 29, 1988, but the central filing system shall not become operational until receipt by the central filing system board of certification for the central filing system for effective financing statements, established in this article, by the United States department of agriculture pursuant to the federal "Food Security Act of 1985", Pub.L. 99-198. Certification for the central filing system was issued by the United States department of agriculture on September 28, 1992.

(2) Colorado adopted this additional article which has no counterpart in the uniform act.

Law reviews: For article, "A Central Filing System for Financing Statements", see 28 Colo. Law. 5 (September 1999).

4-9.5-101. Short title. This article shall be known and may be cited as the "Central Filing of Effective Financing Statement Act".

Source: L. 88: Entire article added, p. 325, § 1, effective May 29.

4-9.5-102. Legislative declaration. The general assembly finds, determines, and declares its intent to adopt a central filing system for security interests relating to farm products pursuant to section 1324 of the federal "Food Security Act of 1985", Pub.L. 99-198. The general assembly further finds, determines, and declares that upon the certification and operation of this central filing system, security interest holders shall use such system in lieu of any other notice provided by section 1324 of the federal "Food Security Act of 1985" for farm products used or produced in the state of Colorado which are included in the central filing system, except as otherwise allowed by this article or required by law.

Source: L. 88: Entire article added, p. 325, § 1, effective May 29.

4-9.5-103. Definitions. As used in this article, unless the context otherwise requires:

(1) (Deleted by amendment, L. 2003, p. 1669, § 2, effective July 1, 2003.)

(2) "Buyer of farm products" or "buyer in the ordinary course of business" means a person who, in the ordinary course of business, buys farm products from a person engaged in farming operations who is in the business of selling farm products.

(2.5) "Central filing officer" means the secretary of state.

(3) "Central filing system" means a system for filing effective financing statements on a statewide basis and which has been certified by the secretary of the United States department of agriculture pursuant to section 1324 of the "Food Security Act of 1985". It is the intent of the general assembly that, effective January 1, 2000, the filing system established by section 4-9-501 shall constitute the central filing system.

(4) "Commission merchant" means any person engaged in the business of receiving any farm product for sale, on commission, or for or on behalf of another person.

(5) "Crop year" means:

(a) For a crop grown in soil, the calendar year in which it is harvested or to be harvested;

(b) For animals, the calendar year in which they are born, acquired, or owned;

(c) For poultry or eggs, the calendar year in which they are sold or to be sold.

(6) "Debtor" means a person who owns a product and subjects it to a security interest, whether or not that person owes a debt to the secured party.

(7) "Effective financing statement" means a record that:

(a) Is an original or reproduced copy thereof, a fax copy, or, if permitted by federal law, regulation, rule, or interpretation, an electronically transmitted filing;

(b) Is filed with the central filing officer by the secured party; and

(c) Is signed, authorized, or otherwise authenticated by the debtor, unless the record is filed by electronic transmission, in which case it shall be signed, authorized, or otherwise authenticated electronically pursuant to section 24-71-101, C.R.S.

(d) to (l) (Deleted by amendment, L. 2006, p. 1142, § 1.)

(8) "Farm product" means an agricultural commodity, a species of livestock used or produced in farming operations, or a product of such crop or livestock in its unmanufactured state, that is in the possession of a person engaged in farming operations. "Farm product" includes, but is not limited to, apples, artichokes, asparagus, barley, cantaloupe, carrots, cattle and calves, chickens, corn, cotton, cucumbers, dry beans, eggs, fish, flax seed, fur-bearing animals, grapes, hay, hogs, honey, honeydew melon, horses, legumes, milk,

muskmelon, oats, onions, pecans, popcorn, potatoes, pumpkins, raspberries, rye, seed crops, sheep and lambs, silage, sorghum grain, soybeans, squash, strawberries, sugar beets, sunflower seeds, sweet corn, tomatoes, trees, triticale, turkeys, vetch, walnuts, watermelon, wheat, and wool. The central filing officer may add other farm products in addition to those specified in this subsection (8) if such products are covered by the general definition contained in this subsection (8).

(9) "Food Security Act of 1985" means Pub.L. 99-198, as amended: Section 1324 thereof has been codified at section 1631 of Title 7 of the United States Code.

(10) "Person" means any individual or any partnership, corporation, trust, or any other business entity.

(11) "Receipt" and other forms of the word "receive" means the earlier of actual receipt or the tenth day after deposit in the United States mails, first-class mail, postage prepaid.

(11.5) "Record", except as used in "for record", "of record", "record or legal title", and "record owner", means information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form.

(12) "Registrant" or "registered buyer" means any buyer of farm products, commission merchant, or selling agent, who has registered with the central filing officer pursuant to section 4-9.5-104.5 (3).

(13) "Secured party" means a person in whose favor there is a security interest.

(14) "Security interest" means an interest in farm products that secures payment or performance of an obligation.

(15) "Selling agent" means any person, other than a commission merchant, who is engaged in the business of negotiating the sale and purchase of any farm product on behalf of a person engaged in farming operations.

(16) "Unique identifier" means a number, combination of numbers or letters, or other identifier selected by the central filing officer using a system or method approved by the United States secretary of agriculture in accordance with the federal "Food Security Act of 1985".

Source: L. 88: Entire article added, p. 325, § 1, effective May 29. **L. 91:** (7)(i) amended, p. 323, § 1, effective May 24. **L. 94:** (7)(a) and (7)(f) amended, p. 1552, § 3, effective July 1. **L. 95:** (1), (7)(f), and (7)(j) amended, p. 1139, § 12, effective July 1, 1996. **L. 96:** (1), (7)(b), and (7)(c) amended, p. 1385, §§ 5, 6, effective July 1. **L. 97:** (7)(d)(IV) and (7)(e) amended, p. 550, § 8, effective April 24. **L. 99:** (1), (3), (7)(b), (7)(f), (7)(j), and (7)(k) amended and (2.5) added, p. 747, § 14, effective July 1. **L. 2001:** (2.5), (3), (7)(e), and (7)(j) amended, p. 1430, § 8, effective July 1. **L. 2003:** (1), (3), (7)(d)(IV), (7)(d)(VI), (8), and (12) amended, p. 1669, § 2, effective July 1. **L. 2004:** (7) amended, p. 1170, § 1, effective July 1. **L. 2006:** (7), (8), and (12) amended and (11.5) and (16) added, p. 1142, § 1, effective (see editor's note).

Editor's note: Section 12 of chapter 249, Session Laws of Colorado 2006, provides that the act amending subsections (7), (8), and (12) and enacting subsections (11.5) and (16) is effective ninety days following certification in writing by the secretary of state to the revisor of statutes that approval of changes to the central filing system enacted by the act has been obtained from the United States department of agriculture, and the secretary of state has implemented the necessary computer system to publish and distribute the master list electronically and is able to do so. The revisor of statutes received certification from the secretary of state on February 29, 2012.

4-9.5-104. Central filing system - repeal. (1) The central filing officer shall be responsible for the design, implementation, and operation of a central filing system for effective financing statements. The system shall provide a means for filing effective financing statements with the central filing officer. The system shall include requirements:

(a) That an effective financing statement be filed in the office of the central filing officer;

(b) That the central filing officer record the date and hour of the filing of effective financing statements; and

(c) That the central filing officer assign a file number to each effective financing statement.

(2) to (6) Repealed.

(7) (Deleted by amendment, L. 99, p. 747, § 15, effective January 1, 2000.)

(8) and (9) Repealed.

Source: L. 88: Entire article added, p. 328, § 1, effective May 29. **L. 91:** (5)(a) amended, p. 323, § 2, effective May 24. **L. 94:** (1) and (5)(a) amended, p. 1552, § 4, effective July 1. **L. 95:** (5)(a) amended, p. 1139, § 13, effective July 1, 1996. **L. 99:** (1), (4), (5)(a), and (7) amended, p. 747, § 15, effective January 1, 2000. **L. 2003:** IP(1), IP(2), IP(3)(a), (4), (5), and (6) amended and (8) added, p. 1670, § 3, effective July 1. **L. 2004:** (5)(a) amended, p. 1172, § 2, effective July 1. **L. 2006:** (9) added by revision, pp. 1143, 1154, §§ 2, 12 (See editor's note).

Editor's note: Subsection (9) provides for the repeal of subsections (2), (3), (4), (5), (6), (8), and (9) effective ninety days following certification in writing by the secretary of state to the revisor of statutes. The revisor of statutes received certification from the secretary of state on February 29, 2012.

4-9.5-104.5. Master list. (1) The central filing officer shall compile all effective financing statements or notices into a master list:

(a) Containing the information referred to in section 4-9.5-105.3;

(b) Organized according to farm product; and

(c) Arranged within each such farm product:

(I) In alphabetical order according to the last name of the individual debtors or, in the case of debtors doing business other than as individuals, the first word in the name of such debtors;

(II) In numerical order according to the social security number, or other unique identifier, of the individual debtors or, in the case of debtors doing business other than as individuals, the federal internal revenue service taxpayer identification number, or other unique identifier, of such debtors;

(III) Geographically by county; and

(IV) By crop year.

(2) (a) The central filing officer shall cause the information on the master list to be produced in lists organized in the same manner as the master list.

(b) If a registered buyer or other interested person so requests, the list or lists for such buyer or person may be limited to any county or group of counties where the farm product is used or produced, or to any crop year or years, or a combination of such identifiers.

(3) All buyers of farm products, commission merchants, selling agents, and other persons may register with the central filing officer to access lists described in subsection (2) of this section. Any buyer of farm products, commission merchant, selling agent, or other person conducting business from multiple locations may be considered as one entity, at its option. Such registration shall be on an annual basis. The central filing officer shall prescribe the process for registration, which shall include the name and address of the registrant and the list or lists described in subsection (2) of this section that such registrant desires to receive. A registration shall be complete when the registrant has provided the required information and paid the prescribed fee. A registrant is deemed to be registered only as to those products, counties, and crop years for which the registrant requests a list.

(4) The lists as produced pursuant to subsection (2) of this section shall be published and distributed by the central filing officer and shall reflect all effective financing statements that are effective as of the date of the compilation of the lists. The central filing officer shall determine the frequency with which the lists identified pursuant to subsection (2) of this section shall be compiled and distributed. Such lists may be distributed on an annual basis with three quarterly cumulative supplements or, if cost-effective, requested by registered buyers, and permitted by applicable federal law, the central filing officer may distribute more frequent supplements as determined by the central filing officer reflecting all new filings, changes, and terminations since the last list. The central filing officer may develop the form in which to distribute lists. If the name of the seller of a farm product is not on a

list requested and received by a registrant, the sale of the farm product to the registrant shall be free of any security interest granted by that seller with respect to the farm product except as to any farm product for which the registrant has received direct notification of the existence of a security interest pursuant to 7 U.S.C. sec. 1631 (e) (1) and (g) (2) (A). The registrant may rely on the representation of the seller as to the seller's identity, so long as the reliance is in good faith.

(5) The central filing officer shall remove from the master list any effective financing statement that has lapsed pursuant to section 4-9.5-105.3 (2) or has been terminated pursuant to section 4-9.5-107.

(6) As soon as practicable, the central filing officer shall publish and distribute the master list electronically.

Source: L. 2006: Entire section added, p. 1146, § 3, effective (see editor's note).

Editor's note: Section 12 of chapter 249, Session Laws of Colorado 2006, provides that the act enacting this section is effective ninety days following certification in writing by the secretary of state to the revisor of statutes that approval of changes to the central filing system enacted by the act has been obtained from the United States department of agriculture, and the secretary of state has implemented the necessary computer system to publish and distribute the master list electronically and is able to do so. The revisor of statutes received certification from the secretary of state on February 29, 2012.

4-9.5-105. Confirmations.

(1) (Deleted by amendment, L. 2006, p. 1148, § 4.)

(2) to (4) (Deleted by amendment, L. 96, p. 1385, § 7, effective July 1, 1996.)

(5) A buyer of farm products, whether or not registered, may rely conclusively on information obtained from the master list published and distributed electronically, regardless of any errors or omissions committed by the central filing officer in the electronic publication or distribution of the master list. If the information obtained electronically confirms that the name of the seller of a specified farm product is not on the master list, the sale of the farm product to the buyer shall be free of any security interest granted by that seller with respect to the farm product and the buyer may rely on the representation of the seller as to the seller's identity, so long as the reliance is in good faith.

Source: L. 88: Entire article added, p. 330, § 1, effective May 29. **L. 94:** (1) and (4) amended, p. 1553, § 5, effective July 1. **L. 96:** (1), (2), (3), and (4) amended, p. 1385, § 7, effective July 1. **L. 99:** (1) and (5) amended, p. 749, § 16, effective January 1, 2000. **L. 2003:** (5) amended, p. 1672, § 4, effective July 1. **L. 2006:** (1) and (5) amended, p. 1148, § 4, effective (see editor's note).

Editor's note: Section 12 of chapter 249, Session Laws of Colorado 2006, provides that the act amending subsections (1) and (5) is effective ninety days following certification in writing by the secretary of state to the revisor of statutes that approval of changes to the central filing system enacted by the act has been obtained from the United States department of agriculture, and the secretary of state has implemented the necessary computer system to publish and distribute the master list electronically and is able to do so. The revisor of statutes received certification from the secretary of state on February 29, 2012.

4-9.5-105.3. Effective financing statements. (1) An effective financing statement shall state:

(a) The name and address of the secured party;

(b) The name and address of the debtor, which, in the case of an individual, shall have the surname appear first, and in the case of a corporation or other entity that is not an individual, shall have the name appear beginning with the first word or character that is not an article or punctuation mark;

(c) The social security number, or other unique identifier, of the debtor or, in the case of a debtor doing business other than as an individual, the federal internal revenue service taxpayer identification number, or other unique identifier, of such debtor;

(d) A description of the farm products subject to the security interest created by the debtor, including:

(I) The amount of the farm products, unless all of a particular farm product is subject to the particular security interest;

(II) The name of each county in which the farm products are produced, stored, or otherwise located or to be produced, stored, or otherwise located; and

(III) The crop year, unless every crop year for the duration of the effective financing statement is subject to the particular security interest.

(e) Further details of the farm products subject to the security interest, if needed to distinguish them from other farm products owned by the same person but not subject to the particular security interest; and

(f) Such other additional information as the central filing officer may require to comply with 7 U.S.C. sec. 1631 or to more effectively carry out the purposes of this article.

(2) An effective financing statement shall remain effective for a period of five years after the date of filing, unless its effectiveness is extended by filing one or more continuation statements in accordance with section 4-9.5-106 (1).

(3) An effective financing statement may:

(a) Cover more than one farm product located in more than one county for any given debtor; and

(b) Cover more than one debtor.

(4) An effective financing statement may not be created by amending a financing statement filed under article 9 of this title.

Source: L. 2006: Entire section added, p. 1148, § 5, effective (see editor's note).

Editor's note: Section 12 of chapter 249, Session Laws of Colorado 2006, provides that the act enacting this section is effective ninety days following certification in writing by the secretary of state to the revisor of statutes that approval of changes to the central filing system enacted by the act has been obtained from the United States department of agriculture, and the secretary of state has implemented the necessary computer system to publish and distribute the master list electronically and is able to do so. The revisor of statutes received certification from the secretary of state on February 29, 2012.

4-9.5-105.7. Amendment of effective financing statements. (1) An effective financing statement may be amended to add or delete collateral, or otherwise to amend the information provided in the effective financing statement, by filing an amendment with the central filing officer that identifies the effective financing statement to which the amendment relates by providing its file number, filing office where originally filed, and date filed.

(2) An effective financing statement that is amended by an amendment that adds collateral is effective as to the added collateral only from the date of the filing of the amendment.

(3) An effective financing statement that is amended by an amendment that adds a debtor is effective as to the added debtor only from the date of the filing of the amendment.

(4) If the security interest is terminated as to one or more of the farm products shown on the filed effective financing statement and the effective financing statement is to remain effective as to one or more other farm products, the secured party shall, within thirty days after such partial termination, file an amendment reflecting such partial termination with the central filing officer. If the affected secured party fails to file an amendment reflecting such partial termination within the thirty-day period, the secured party shall be liable to the debtor for five hundred dollars and, in addition, for any loss caused to the debtor by such failure.

(5) An amendment to an effective financing statement to delete collateral does not amend or otherwise impair the perfection of any security interest perfected by the effective financing statement for purposes of article 9 of this title.

Source: L. 2006: Entire section added, p. 1148, § 5, effective (see editor's note).

Editor's note: Section 12 of chapter 249, Session Laws of Colorado 2006, provides that the act enacting this section is effective ninety days following certification in writing by the secretary of state to the revisor of statutes that approval of changes to the central filing system enacted by the act has been obtained from the United States department of agriculture, and the secretary of state has implemented the necessary computer system to publish and distribute the master list electronically and is able to do so. The revisor of statutes received certification from the secretary of state on February 29, 2012.

4-9.5-106. Continuation statements. (1) A continuation statement may be filed within six months prior to the expiration of the five-year period of effectiveness of an effective financing statement. A continuation statement shall identify the effective financing statement by file number, filing office where originally filed, and date filed. Upon timely filing of the continuation statement, the effectiveness of the effective financing statement shall be continued for five years after the last date to which the effective financing statement was effective, whereupon its effectiveness shall lapse unless another continuation statement is filed prior to such lapse. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the effective financing statement.

(2) The effectiveness of an effective financing statement that was filed before July 1, 1996, and that had not otherwise lapsed by December 31, 1997, shall be deemed to have lapsed in the manner provided in subsection (1) of this section on December 31, 1997, unless a continuation statement was filed on or after July 1, 1996, but on or before December 31, 1997, that complied with the requirements of subsection (1) of this section. The filing of a continuation statement pursuant to this subsection (2) shall have extended the effectiveness of the effective financing statement for five years after the last date to which the effective financing statement would otherwise have been effective, whereupon it shall have lapsed in the manner set forth in subsection (1) of this section unless further continuation statements were filed in the manner and within the time periods prescribed in subsection (1) of this section in order to prevent such lapse.

(3) (Deleted by amendment, L. 2006, p. 1150, § 6.)

(4) No continuation statement filed pursuant to this section on or after July 1, 1995, shall be ineffective solely because it failed to include a statement that the original financing statement is still effective.

Source: L. 88: Entire article added, p. 330, § 1, effective May 29. **L. 97:** Entire section amended, p. 550, § 9, effective April 24. **L. 97, 1st Ex. Sess.:** (2) amended and (4) added, p. 7, § 3, effective October 22. **L. 2006:** (1), (2), and (3) amended, p. 1150, § 6, effective (see editor's note).

Editor's note: (1) Subsection (2) was amended and subsection (4) was added by Senate Bill 97S-005 at the first extraordinary session of the sixty-first general assembly in 1997 to correct a technical error. The amendment removes a requirement erroneously left in the law that every continuation statement filed under the "Uniform Commercial Code - Secured Transactions" or the "Central Filing of Effective Financing Statements Act" on or after July 1, 1995, include a statement that the financing statement that is being continued by the filing remains effective. It substitutes language that validates continuation statements filed on or after July 1, 1995, in a form that does not include such statement.

(2) Section 12 of chapter 249, Session Laws of Colorado 2006, provides that the act amending subsections (1), (2), and (3) is effective ninety days following certification in writing by the secretary of state to the revisor of statutes that approval of changes to the central filing system enacted by the act has been obtained from the United States department of agriculture, and the secretary of state has implemented the necessary computer system to publish and distribute the master list electronically and is able to do so. The revisor of statutes received certification from the secretary of state on February 29, 2012.

4-9.5-107. Termination statement. (1) The secured party identified in an effective financing statement may at any time, and without regard to whether there is any outstanding secured obligation or commitment to make advances, incur obligations, or otherwise give value, file with the central filing officer a termination statement with respect to such

effective financing statement pursuant to this section and provide notice to the debtor of such filing.

(1.3) (a) Unless the debtor otherwise requests, whenever there is no outstanding secured obligation and no commitment to make advances, incur obligations, or otherwise give value, the secured party identified in an effective financing statement relating to such obligation or commitment shall, within thirty days, terminate such effective financing statement by filing with the central filing officer either:

(I) A termination statement pursuant to this section; or

(II) A termination statement pursuant to article 9 of this title.

(b) If a termination statement is filed pursuant to either subparagraph (I) or (II) of paragraph (a) of this subsection (1.3), the secured party shall provide notice to the debtor of such filing. If the secured party fails to file a required termination statement within the thirty-day period, the secured party shall be liable to the debtor for one thousand dollars, and, in addition, for any loss caused to the debtor by such failure.

(1.5) A termination statement filed pursuant to either subsection (1) or subparagraph (I) of paragraph (a) of subsection (1.3) of this section does not terminate or otherwise impair the perfection of any security interest perfected by the effective financing statement for purposes of article 9 of this title.

(2) (a) The termination statement shall:

(I) Be signed, authorized, or otherwise authenticated by the secured party, and if such notice is filed by electronic transmission it shall be signed electronically, pursuant to section 24-71-101, C.R.S.;

(II) Identify the effective financing statement, the effectiveness of which is to be terminated, by file number, filing office where originally filed, and date filed; and

(III) State that the effective financing statement is to be removed from the master list.

(b) The effectiveness of a terminated effective financing statement shall cease as of the date and hour of filing the termination statement by the central filing officer.

Source: L. 88: Entire article added, p. 331, § 1, effective May 29. **L. 97:** (2) amended, p. 551, § 10, effective April 24. **L. 99:** (1) and (2)(b) amended, p. 749, § 17, effective January 1, 2000. **L. 2001:** (1) and (2)(a)(I) amended, p. 1430, § 9, effective July 1. **L. 2004:** (2)(a)(I) amended, p. 1172, § 3, effective July 1. **L. 2006:** (1) and (2) amended and (1.3) and (1.5) added, p. 1150, § 7, effective (see editor's note). **L. 2008:** (1.5) amended, p. 268, § 7, effective (see editor's note).

Editor's note: (1) Section 12 of chapter 249, Session Laws of Colorado 2006, provides that the act amending subsections (1) and (2) and enacting subsections (1.3) and (1.5) is effective ninety days following certification in writing by the secretary of state to the revisor of statutes that approval of changes to the central filing system enacted by the act has been obtained from the United States department of agriculture, and the secretary of state has implemented the necessary computer system to publish and distribute the master list electronically and is able to do so. The revisor of statutes received certification from the secretary of state on February 29, 2012.

(2) Section 9 of chapter 84, Session Laws of Colorado 2008, provides that the act amending subsection (1.5) is effective simultaneously with Senate Bill 06-188. As of publication date, Senate Bill 06-188 had not yet become effective. For further explanation, see section 12 of chapter 249, Session Laws of Colorado 2006.

4-9.5-108. Filings generally. (1) Each record filed in the central filing system shall contain all information required by the laws of this state to be contained in the record. Each such record shall:

(a) Be on or in such medium as may be acceptable to the central filing officer and from which the central filing officer may create a physical document that contains all of the information in the record. The central filing officer may require that the record be delivered by any one or more means or on or in any one or more media as may be acceptable to the central filing officer. The central filing officer is not required to accept for filing a record that is not delivered by a means and in a medium that complies with the requirements then established by the central filing officer for the delivery and filing of records. If the central filing officer permits a record to be delivered on paper, the record shall be typewritten or

machine printed, and the central filing officer may impose reasonable requirements upon the dimensions, legibility, quality and color of such paper, and typewriting or printing. If the delivery of a record subject to this article for filing is required or permitted to be accomplished electronically, then the central filing officer may prescribe the format and other attributes of the record and may refuse to permit such record to be accompanied by any physical document.

(b) Be in the English language;

(c) Include any form or cover sheet, or both, required pursuant to section 4-9.5-108.5;

(d) Be delivered to the central filing officer for filing; and

(e) Be accompanied by all required fees.

(2) A record filed pursuant to this article shall not constitute notice for purposes of section 38-35-109, C.R.S.

(3) Any continuation, termination, amendment, or assignment of an effective financing statement shall be signed, authorized, or otherwise authenticated by the secured party, and, in the case of an amendment that adds collateral or adds an additional debtor, by the affected debtor or debtors. If such filing is made by electronic transmission, it shall be signed electronically, pursuant to section 24-71-101, C.R.S.

(4) The provisions of part 5 of article 9 of this title regarding the filing of records shall apply to the filing of records under this article to the extent not inconsistent therewith.

Source: L. 88: Entire article added, p. 331, § 1, effective May 29. **L. 94:** Entire section amended, p. 1554, § 6, effective July 1. **L. 95:** Entire section amended, p. 1140, § 14, effective July 1, 1996. **L. 96:** (1) amended, p. 1386, § 8, effective July 1. **L. 97:** (3) added, p. 551, § 11, effective April 24. **L. 99:** (1) amended, p. 749, § 18, effective January 1, 2000. **L. 2001:** (1) and (3) amended, p. 1431, § 10, effective July 1. **L. 2003:** (1) amended, p. 1672, § 5, effective July 1. **L. 2004:** (3) amended, p. 1173, § 4, effective July 1. **L. 2006:** Entire section amended, p. 1152, § 8, effective (see editor's note).

Editor's note: Section 12 of chapter 249, Session Laws of Colorado 2006, provides that the act amending this section is effective ninety days following certification in writing by the secretary of state to the revisor of statutes that approval of changes to the central filing system enacted by the act has been obtained from the United States department of agriculture, and the secretary of state has implemented the necessary computer system to publish and distribute the master list electronically and is able to do so. The revisor of statutes received certification from the secretary of state on February 29, 2012.

4-9.5-108.5. Forms. The central filing officer may prepare and furnish a form for any record that is subject to this article and may require the use of any such form.

Source: L. 2006: Entire section added, p. 1153, § 9, effective (see editor's note).

Editor's note: Section 12 of chapter 249, Session Laws of Colorado 2006, provides that the act enacting this section is effective ninety days following certification in writing by the secretary of state to the revisor of statutes that approval of changes to the central filing system enacted by the act has been obtained from the United States department of agriculture, and the secretary of state has implemented the necessary computer system to publish and distribute the master list electronically and is able to do so. The revisor of statutes received certification from the secretary of state on February 29, 2012.

4-9.5-109. "Food Security Act of 1985". Whether a buyer of farm products takes subject to a security interest shall be determined by section 1324 of the federal "Food Security Act of 1985" and applicable provisions of Colorado law.

Source: L. 88: Entire article added, p. 331, § 1, effective May 29.

4-9.5-110. Fees - rules - federal certification.

(1) Repealed.

(1.5) The central filing officer shall charge and collect fees and other charges, which shall be determined and collected pursuant to section 24-21-104 (3), C.R.S., for:

(a) Distributing the master list;

(b) Furnishing any information;

(c) Furnishing a copy of any filed record;

(d) Filing any record required or permitted to be filed under this article.

(2) The central filing officer is hereby authorized to adopt such rules as are necessary to carry out the provisions of this article and to conform the central filing system to the requirements of the federal "Food Security Act of 1985".

(3) The central filing officer may contract with one or more public or private parties to perform some or all of its duties under this article; except that the central filing officer may not delegate the power to make rules or regulations, conduct public hearings, prescribe forms, and establish services and fees therefor.

(4) (Deleted by amendment, L. 2003, p. 1672, § 6, effective July 1, 2003.)

(5) Revenues collected by the central filing officer pursuant to this article shall be transmitted to the state treasurer, who shall credit the same to the department of state cash fund created in section 24-21-104 (3), C.R.S.

(6) Repealed.

Source: L. 88: Entire article added, p. 331, § 1, effective May 29. **L. 95:** (1) and (3) amended, p. 1140, § 15, effective July 1, 1996. **L. 96:** (1) repealed, p. 1386, § 9, effective July 1. **L. 99:** (4) added, p. 750, § 19, effective July 1. **L. 2003:** (2), (3), and (4) amended and (5) and (6) added, p. 1672, § 6, effective July 1. **L. 2006:** Entire section amended, p. 1153, § 10, effective (see editor's note).

Editor's note: (1) Subsection (6)(b) provided for the repeal of subsection (6), effective July 1, 2004. (See L. 2003, p. 1672.)

(2) Section 12 of chapter 249, Session Laws of Colorado 2006, provides that the act amending this section is effective ninety days following certification in writing by the secretary of state to the revisor of statutes that approval of changes to the central filing system enacted by the act has been obtained from the United States department of agriculture, and the secretary of state has implemented the necessary computer system to publish and distribute the master list electronically and is able to do so. The revisor of statutes received certification from the secretary of state on February 29, 2012.

4-9.5-111. Penalties. Any debtor or third party who provides any false or misleading information concerning the name of the owner of any farm products or the existence of any security interest affecting farm products with the intent to deprive the secured party of any of his or her security under the security interest or to defraud or mislead the buyer of any farm product as to the existence of the security interest or fails to pay to the secured party any moneys realized out of the sale of collateral in violation of any security agreement and with the intent to deprive the secured party of such party's rights thereto, or makes a filing subject to section 4-9.5-108 (3) that is not signed, authorized, or otherwise authenticated by the secured party as required by section 4-9.5-108 (3), shall be deemed to have violated section 18-5-206, C.R.S., and shall be subject to the penalties described in said section. Any penalty so collected shall be transmitted to the state treasurer, who shall credit the same to the department of state cash fund created in section 24-21-104 (3), C.R.S.

Source: L. 88: Entire article added, p. 332, § 1, effective May 29. **L. 97:** Entire section amended, p. 552, § 12, effective April 24. **L. 2003:** Entire section amended, p. 1673, § 7, effective July 1. **L. 2004:** Entire section amended, p. 1173, § 5, effective July 1.

4-9.5-112. Severability of provisions. (Repealed)

Source: L. 88: Entire article added, p. 332, § 1, effective May 29. **L. 2003:** Entire section repealed, p. 1669, § 1, effective July 1.

4-9.5-112.5. Immunity. (1) Except in cases of willful misconduct or bad faith, the contractors retained by the central filing officer, as well as the employees of such contractors, shall be exempt from personal liability as a result of an error or omission in receiving, entering, storing, or providing information or performing their duties as required by this title.

(2) Any error or omission described in subsection (1) of this section shall constitute a tort and not a breach of any express or implied contract.

Source: L. 2003: Entire section added, p. 1673, § 8, effective July 1.

4-9.5-113. Repeal of article. (Repealed)

Source: L. 94: Entire section added, p. 1554, § 7, effective July 1. **L. 95:** Entire section repealed, p. 1140, § 16, effective July 1.

ARTICLE 9.7

Colorado Statutory Lien Registration Act

Editor's note: Section 9 of chapter 84, Session Laws of Colorado 2008, provides that the act enacting this article is effective simultaneously with Senate Bill 06-188. As of publication date, Senate Bill 06-188 had not yet become effective. For further explanation, see section 12 of chapter 249, Session Laws of Colorado 2006. The revisor of statutes received certification from the secretary of state, as specified in said chapter 249, on February 29, 2012.

4-9.7-101. Short title. This article shall be known and may be cited as the "Colorado Statutory Lien Registration Act".

Editor's note: This section is effective upon certification by the secretary of state. (See the editor's note following the article heading.)

Source: L. 2008: Entire article added, p. 268, § 8, effective (see editor's note following the article heading).

4-9.7-102. Scope. (a) This article shall apply to the filing of a record relating to a designated statutory lien.

(b) This article shall not apply to the filing of:

(1) Notices, certificates, or other records pertaining to any lien created pursuant to the laws of the United States; or

(2) A financing statement or other record filed pursuant to article 9 or 9.5 of this title or any successor statutes.

(c) This article shall not be construed to create a filing requirement for any lien where the applicable substantive statute does not require filing.

Editor's note: This section is effective upon certification by the secretary of state. (See the editor's note following the article heading.)

Source: L. 2008: Entire article added, p. 268, § 8, effective (see editor's note following the article heading).

4-9.7-103. Definitions. (a) As used in this article, unless the context otherwise requires:

(1) "Claimant" means a person identified as a beneficiary or owner of a designated statutory lien in a notice of lien or notice of amendment filed in the office of the secretary of state pursuant to this article.

(2) "Continue" means to renew or otherwise extend the effectiveness of a notice of lien.

(3) "Designated statutory lien" means:

(A) A harvester's lien pursuant to article 24.5 of title 38, C.R.S.;

(B) An agistor's lien pursuant to part 2 of article 20 of title 38, C.R.S.;

(C) A hospital lien pursuant to article 27 of title 38, C.R.S.;

(D) A restitution lien pursuant to section 16-18.5-104, C.R.S.;

(E) A child support lien pursuant to section 14-10-122, C.R.S.;

(F) A security interest held by a housing authority pursuant to section 29-4-712, C.R.S.; or

(G) Any other lien provided for by a statute of this state that requires or expressly permits a notice or other record creating, evidencing, or perfecting the lien to be filed in the office of the secretary of state, except as provided in section 4-9.7-102 (b) and (c).

(4) "Notice of amendment" means a record filed in the office of the secretary of state pursuant to this article that changes, corrects, continues, terminates, subordinates, or otherwise modifies a notice of lien.

(5) "Notice of lien" means a record filed in the office of the secretary of state pursuant to this article that identifies one or more claimants with respect to a designated statutory lien; identifies, to the extent required by the applicable substantive statute, the property asserted to be subject to the lien; identifies the owner or owners of the property; and otherwise complies with the requirements of this article.

(6) "Owner" means a person identified in a notice of lien or notice of amendment in the office of the secretary of state pursuant to this article as an owner of property subject to a designated statutory lien.

(7) "Record", except as used in the phrases "for record", "of record", "record or legal title", and "record owner", means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(8) "Substantive statute" means the statute creating, providing for, or giving rise to a designated statutory lien.

(9) "Taxpayer identification number" means a social security number, an employer identification number, or an individual taxpayer identification number.

(10) "Terminate" means to release or otherwise extinguish the effectiveness of a notice of lien.

Editor's note: This section is effective upon certification by the secretary of state. (See the editor's note following the article heading.)

Source: L. 2008: Entire article added, p. 269, § 8, effective (see editor's note following the article heading).

4-9.7-104. Contents of a notice of lien or notice of amendment. (a) (1) A notice of lien shall state:

(A) The name of one or more owners;

(B) The name of one or more claimants;

(C) A citation to the section of the substantive statute pursuant to which the notice of lien is filed;

(D) To the extent required by the applicable substantive statute, an identification of the property asserted to be subject to a designated statutory lien and any other information that the applicable substantive statute requires to be contained in or included with the notice of lien;

(E) That any other information or record required to be filed with the office of the secretary of state pursuant to the applicable substantive statute has been included with or attached to the notice of lien; and

(F) Such additional information as the secretary of state may require.

(2) A notice of lien may state:

(A) The mailing address of one or more owners; and

(B) The mailing address of one or more claimants.

(b) (1) A notice of amendment shall state:

(A) The original filing number of the notice of lien to which the notice of amendment relates;

(B) That any other information or record required to be filed with the office of the secretary of state pursuant to the applicable substantive statute has been included with or attached to the notice of amendment; and

(C) Any additional information that the secretary of state requires.

(2) A notice of amendment may contain any information necessary to indicate the manner and extent to which the notice of amendment affects the notice of lien.

(c) A notice of lien shall remain effective for the period provided for by the applicable substantive statute or until a notice of amendment that terminates the notice of lien is filed in the office of the secretary of state.

Editor's note: This section is effective upon certification by the secretary of state. (See the editor's note following the article heading.)

Source: L. 2008: Entire article added, p. 270, § 8, effective (see editor's note following the article heading).

4-9.7-105. Acceptance and refusal to accept for filing. (a) The secretary of state shall refuse to accept a notice of lien or notice of amendment for filing if:

(1) The applicable filing fee is not tendered;

(2) The notice is not communicated by a method of communication authorized by the secretary of state;

(3) The notice of lien does not state the name of an owner;

(4) The notice of lien does not state the name of a claimant;

(5) The notice of amendment does not indicate the original file number of the notice of lien to which the notice of amendment relates; or

(6) The notice of lien or notice of amendment fails to state any additional information that the secretary of state requires.

(b) The secretary of state may refuse to accept a notice of lien or notice of amendment for filing if the notice of lien or notice of amendment does not include the address of one or more claimants.

(c) Filing does not occur with respect to a notice of lien or notice of amendment that the secretary of state refuses to accept for a reason set forth in subsection (a) or (b) of this section.

Editor's note: This section is effective upon certification by the secretary of state. (See the editor's note following the article heading.)

Source: L. 2008: Entire article added, p. 271, § 8, effective (see editor's note following the article heading).

4-9.7-106. Duties of filing officer. (a) If a notice of lien is communicated to and accepted by the secretary of state for filing, the secretary of state shall cause the notice to be marked, maintained, and indexed in accordance with the provisions of section 4-9-519 as if the notice were a financing statement and each owner identified in the notice were a debtor within the meaning of section 4-9-519.

(b) If a notice of amendment is communicated to and accepted by the secretary of state for filing, the secretary of state shall:

(1) Cause the notice of amendment to be marked, maintained, and indexed as if the notice were an amendment of a financing statement within the meaning of section 4-9-512;

(2) If the notice of amendment terminates a notice of lien, cause the notice of amendment to be marked, maintained, and indexed as if the notice were a termination statement within the meaning of section 4-9-513; or

(3) If the notice of amendment continues a notice of lien, cause the notice of amendment to be marked, maintained, and indexed as if the notice were a continuation statement as defined in section 4-9-102 (27) and extend the effectiveness of the notice of lien by the appropriate period pursuant to the applicable substantive statute.

(c) If the secretary of state refuses to accept a notice of lien or notice of amendment for filing, the secretary of state shall communicate to the person that presented the record the fact of and reason for the refusal. The communication shall be made at the time and in the manner prescribed by the rules adopted by the secretary of state pursuant to section 4-9.7-109.

(d) The secretary of state may remove a notice of lien from the records of the secretary of state one year after the notice expires in accordance with section 4-9.7-104 (d).

(e) The secretary of state shall communicate or otherwise make available in a record the following information to any person that requests the information:

(1) Whether there is on file on a date and time specified by the secretary of state any notice of lien or notice of amendment that:

(A) Designates a particular owner; and

(B) Has not expired under section 4-9.7-104 (d); and

(C) If the request so states, has expired under section 4-9.7-104 (d) and a record of which is maintained by the secretary of state under subsection (d) of this section;

(2) The date and time of filing of each notice of lien and notice of amendment described in paragraph (1) of this subsection (e); and

(3) The information provided in each notice of lien and notice of amendment described in paragraph (1) of this subsection (e).

Editor's note: This section is effective upon certification by the secretary of state. (See the editor's note following the article heading.)

Source: L. 2008: Entire article added, p. 271, § 8, effective (see editor's note following the article heading).

4-9.7-107. Fees. Subject to section 24-75-402, C.R.S., fees for services rendered by the secretary of state under this article shall be determined and collected pursuant to section 24-21-104, C.R.S.

Editor's note: This section is effective upon certification by the secretary of state. (See the editor's note following the article heading.)

Source: L. 2008: Entire article added, p. 273, § 8, effective (see editor's note following the article heading).

4-9.7-108. Effect of filing. A notice of lien or notice of amendment that is communicated to the office of the secretary of state with tender of the filing fee, but which the secretary of state wrongfully refuses to accept, is effective as a filed record in the records of the secretary of state except as against a purchaser of the property described in the notice who gives value in reasonable reliance upon the absence of the record in the records of the secretary of state.

Editor's note: This section is effective upon certification by the secretary of state. (See the editor's note following the article heading.)

Source: L. 2008: Entire article added, p. 273, § 8, effective (see editor's note following the article heading).

4-9.7-109. Filing office - rules. (a) The secretary of state shall adopt and publish any rules necessary to implement this article. The rules shall be:

(1) Consistent with this article; and

(2) Adopted and published in accordance with the "State Administrative Procedure Act", article 4 of title 24, C.R.S.

Editor's note: This section is effective upon certification by the secretary of state. (See the editor's note following the article heading.)

Source: L. 2008: Entire article added, p. 273, § 8, effective (see editor's note following the article heading).

ARTICLE 10

Effective Date

4-10-101 to 4-10-208. (Repealed)

Source: L. 2001: Entire article repealed, p. 1448, § 48, effective July 1.

Editor's note: This article was numbered as article 10 of chapter 155, C.R.S. 1963. For amendments to this article prior to its repeal in 2001, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

ARTICLE 11

Fees

4-11-101 and 4-11-102. (Repealed)

Source: L. 2001: Entire article repealed, p. 1448, § 48, effective July 1.

Editor's note: This article was numbered as article 11 of chapter 155, C.R.S. 1963. For amendments to this article prior to its repeal in 2001, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

TITLE 5

CONSUMER CREDIT CODE

TITLE 5

CONSUMER CREDIT CODE

Editor's note: This title was numbered as chapter 73 in C.R.S. 1963. The provisions of this title were repealed and reenacted in 1971, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this title prior to 1971, consult the Colorado statutory research explanatory note beginning on page vii in the front of this volume.

CONSUMER CREDIT CODE

RENTAL PURCHASE

INTEREST RATES

CONSUMER CREDIT CODE

Editor's note: When originally enacted in 1971, articles 1 through 3 and 4 through 6 were based upon the Uniform Consumer Credit Code promulgated by the National Conference of Commissioners on Uniform State Laws; however it has been substantially amended in subsequent years and was the subject of a major rewrite in the 2000 session based upon recommendations of the office of the attorney general.

ARTICLE 1

General Provisions and Definitions

Editor's note: This article was numbered as article 1 of chapter 73, C.R.S. 1963. This title was repealed and reenacted in 1971, and this article was subsequently repealed and reenacted in 2000, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 2000, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume and the editor's note following the title heading. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated. For a detailed comparison of this article, see the comparative tables located in the back of the index.

PART 1

SHORT TITLE, CONSTRUCTION, GENERAL PROVISIONS

PART 2

SCOPE AND JURISDICTION

PART 3

DEFINITIONS

PART 1

SHORT TITLE, CONSTRUCTION, GENERAL PROVISIONS

5-1-101. Short title. Articles 1 to 9 of this title shall be known and may be cited as the "Uniform Consumer Credit Code", referred to in said articles as the "code".

Source: L. 2000: Entire article R&RE, p. 1178, § 1, effective July 1.

Editor's note: This section is similar to former § 5-1-101, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "The Basic Exclusions from the UCCC: A Road Map for Traversing a New World With Oblique Guides", see 43 U. Colo. L. Rev. 269 (1972). For article, "The 'New and Improved' Colorado Uniform Consumer Credit Code", see 29 Colo. Law. 5 (December 2000).

5-1-102. Purposes - rules of construction. (1) This code shall be liberally construed and applied to promote its underlying purposes and policies.

(2) The underlying purposes and policies of this code are:

(a) To simplify, clarify, and modernize the law governing retail installment sales, consumer credit, small loans, and usury;

(b) To provide rate ceilings to assure an adequate supply of credit to consumers;

(c) To further consumer understanding of the terms of credit transactions and to foster competition among suppliers of consumer credit so that consumers may obtain credit at reasonable cost;

(d) To protect consumer buyers, lessees, and borrowers against unfair practices by some suppliers of consumer credit, having due regard for the interests of legitimate and scrupulous creditors;

(e) To permit and encourage the development of fair and economically sound consumer credit practices;

(f) To conform the regulation of consumer credit transactions to the policies of the federal "Truth in Lending Act" and the federal "Consumer Leasing Act"; and

(g) To make uniform the law, including administrative rules, among the various jurisdictions.

(3) A reference to a requirement imposed by this code includes reference to a related rule of the administrator adopted pursuant to this code.

Source: L. 2000: Entire article R&RE, p. 1178, § 1, effective July 1.

Editor's note: This section is similar to former § 5-1-102, as it existed prior to 2000.

Cross references: For the definitions and federal statutory cites of the "Truth in Lending Act" and the "Consumer Leasing Act", see § 5-1-302.

ANNOTATION

Applied in Strader v. Beneficial Fin. Co., 191 Colo. 206, 551 P.2d 720 (1976) (decided prior to 2000 repeal and reenactment).

5-1-103. Supplementary general principles of law applicable. Unless displaced by the particular provisions of this code, the "Uniform Commercial Code" and the principles of law and equity, including the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause, supplement the provisions of this code.

Source: L. 2000: Entire article R&RE, p. 1179, § 1, effective July 1.

Editor's note: This section is similar to former § 5-1-103, as it existed prior to 2000.

Cross references: For the "Uniform Commercial Code", see title 4.

ANNOTATION

Applied in D.E.B. Adjustment Co. v. Cawthorne, 623 P.2d 82 (Colo. App. 1981) (decided prior to 2000 repeal and reenactment).

5-1-104. Construction against implicit repeal. This code being a general act intended as a unified coverage of its subject matter, no part of it is deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided.

Source: L. 2000: Entire article R&RE, p. 1179, § 1 effective July 1.

Editor's note: This section is similar to former § 5-1-104, as it existed prior to 2000.

5-1-105. Severability clause. If any provision of this code or the application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of this code which can be given effect without the invalid provision or application, and to this end the provisions of this code are declared to be severable.

Source: L. 2000: Entire article R&RE, p. 1179, § 1, effective July 1.

Editor's note: This section is similar to former § 5-1-105, as it existed prior to 2000.

5-1-106. Waiver - agreement to forego rights - settlement of claims. (1) Except as otherwise provided in this code, a consumer may not waive or agree to forego rights or benefits under this code.

(2) A claim by a consumer against a creditor for an excess charge, other violation of this code, or civil penalty, or a claim against a consumer for default or breach of a duty imposed by this code, if disputed in good faith, may be settled by agreement.

(3) A claim, whether or not disputed, against a consumer, may be settled for less value than the amount claimed.

(4) A settlement in which the consumer waives or agrees to forego rights or benefits under this code is invalid if the court as a matter of law finds the settlement to have been

unconscionable at the time it was made. The competence of the consumer, any deception or coercion practiced upon the consumer, the nature and extent of the legal advice received by the consumer, and the value of the consideration are relevant to the issue of unconscionability.

Source: L. 2000: Entire article R&RE, p. 1179, § 1, effective July 1.

Editor's note: This section is similar to former § 5-1-107, as it existed prior to 2000.

5-1-107. Effect of code on powers of organizations. (1) This code prescribes maximum charges for all creditors extending consumer credit except lessors and those excluded in sections 5-1-202 and 5-2-213 (2) (b) and displaces existing limitations on the powers of those creditors based on maximum charges.

(2) With respect to sellers of goods or services, small loan companies, licensed lenders, consumer and sales finance companies, industrial banks and loan companies, and commercial banks and trust companies, this code displaces existing limitations on their powers based solely on amount or duration of credit.

(3) Except as provided in subsection (1) of this section, this code does not displace limitations on powers of credit unions, savings banks, savings and loan associations, or other thrift institutions whether organized for the profit of shareholders or as mutual organizations.

(4) Except as provided in subsections (1) and (2) of this section, this code does not displace:

(a) Limitations on powers of supervised financial organizations, as defined in section 5-1-301 (45), with respect to the amount of a loan to a single borrower, the ratio of a loan to the value of collateral, the duration of a loan secured by an interest in land, or other similar restrictions designed to protect deposits; or

(b) Limitations on powers an organization is authorized to exercise under the laws of this state or the United States.

Source: L. 2000: Entire article R&RE, p. 1180, § 1, effective July 1.

Editor's note: This section is similar to former § 5-1-108, as it existed prior to 2000.

PART 2

SCOPE AND JURISDICTION

5-1-201. Territorial application - definitions. (1) Except as otherwise provided in this section, this code applies to consumer credit transactions made in this state and to modifications, including refinancing, consolidations, and deferrals, made in this state, of consumer credit transactions, wherever made. For purposes of this code, a consumer credit transaction is made in this state if:

(a) A written agreement evidencing the obligation or offer of the consumer is received by the creditor in this state; or

(b) A consumer who is a resident of this state enters into the transaction with a creditor who has solicited or advertised in this state by any means, including but not limited to mail, brochure, telephone, print, radio, television, internet, or any other electronic means.

(2) Notwithstanding paragraph (b) of subsection (1) of this section, unless made subject to this code by agreement of the parties, a consumer credit transaction is not made in this state if a resident of this state enters into the transaction while physically present in another state.

(3) Part 1 of article 5 of this title and sections 5-3-104 and 5-3-105 apply to actions or other proceedings brought in this state to enforce rights arising out of a consumer credit transaction, or modification thereof, wherever made.

(4) If a consumer credit transaction, or modification thereof, is made in another state with a person who is a resident of this state when the consumer credit transaction or modification is made, the following provisions apply as though the transaction occurred in this state:

(a) A creditor, or assignee of the creditor's rights, may not collect charges through actions or other proceedings in excess of those permitted by this code; and

(b) A creditor, or assignee of the creditor's rights, may not enforce rights against the consumer that violate the provisions of this code on limitations on agreements and practices.

(5) Except as provided in subsection (3) of this section, a consumer credit transaction, or modification thereof, made in another state with a person who was not a resident of this state when the consumer credit transaction or modification was made is valid and enforceable in this state according to its terms to the extent that it is valid and enforceable under the laws of the state applicable to the transaction.

(6) For the purposes of this code, the "residence" of a consumer is the address given by the consumer as the consumer's residence in any writing provided by the consumer in connection with a credit transaction. Until the consumer notifies the creditor of a new or different address, the given address is presumed to be unchanged.

(7) Notwithstanding other provisions of this section:

(a) Except as provided in subsection (3) of this section, this code does not apply if the consumer is not a resident of this state at the time of a credit transaction and the parties then agree that the law of the consumer's residence applies; and

(b) This code applies if the consumer is a resident of this state at the time of a credit transaction and the parties then agree that the law of this state applies.

(8) Except as provided in subsection (7) of this section, an agreement by a consumer is invalid with respect to consumer credit transactions, or modifications thereof, to which this code applies when such agreement provides that:

(a) The law of another state shall apply;

(b) The consumer consents to the jurisdiction of another state; or

(c) Venue is fixed.

(9) The following provisions of this code specify the applicable law governing certain cases:

(a) Section 5-6-102 on the powers and functions of the administrator; and

(b) Section 5-6-201 on notification and fees.

(10) For the purpose of subsection (1) of this section, "receive" means obtained as a result of physical delivery, transmission, or communication to one who has actual or apparent authority to act for the creditor in this state whether or not approval, acceptance, or ratification by any other agent or representative of such creditor in some other state is necessary to give legal consequence to the consumer credit transaction.

(11) Notwithstanding any other provision of this section, this code applies to any consumer insurance premium loan made to a resident of this state.

Source: L. 2000: Entire article R&RE, p. 1180, § 1, effective July 1.

Editor's note: This section is similar to former § 5-1-201, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982). For article, "Colorado Usury: The Sequel - Parts I and 2", see 23 Colo. Law. 565 and 829 (1994).

Applied in D.E.B. Adjustment Co. v. Cawthorne, 623 P.2d 82 (Colo. App. 1981) (decided prior to 2000 repeal and reenactment).

5-1-202. Exclusions. (1) This code does not apply to:

(a) Extensions of credit to government or governmental agencies or instrumentalities;

(b) Except as otherwise provided in article 4 of this title, the sale of insurance if there is no legal obligation to pay installments of the premium and the insurance may terminate or be canceled after nonpayment of an installment of the premium;

(c) Transactions under public utility or common carrier tariffs if a subdivision or agency of this state or of the United States regulates the charges for the services involved, the charges for delayed payment, and any discount allowed for early payment;

(d) (I) With respect to contracts for purchase entered into by a pawnbroker, as the terms are defined in section 12-56-101, C.R.S., the rates and charges, and the disclosure of rates and charges, if the rates and charges do not exceed the fixed price permitted by section 12-56-101 (2), C.R.S. The exclusion in this subparagraph (I) applies to pawnbrokers who are:

(A) Licensed by a local licensing authority pursuant to section 12-56-102, C.R.S.; or

(B) Regulated, with respect to rates and charges, by a local governing authority pursuant to section 12-56-102, C.R.S.

(II) The exclusion in subparagraph (I) of this paragraph (d) also applies to pawnbrokers authorized to make supervised loans under section 5-2-301 with respect to contracts for purchase; except that the exclusion does not apply to the disclosure of rates and charges of pawnbrokers authorized to make supervised loans.

(e) The disclosure of rates and charges in connection with transactions in securities and commodities accounts by a broker-dealer registered with the securities and exchange commission;

(f) Loans made, originated, disbursed, serviced, or guaranteed by an agency, instrumentality, or political subdivision of the state pursuant to article 3.1 of title 23, C.R.S.

Source: L. 2000: Entire article R&RE, p. 1182, § 1, effective July 1. **L. 2012:** IP(1) and (1)(d) amended, (HB 12-1328), ch. 218, p. 936, § 1, effective August 8.

Editor's note: This section is similar to former § 5-1-202, as it existed prior to 2000.

Cross references: For regulation of insurance agents, brokers, and representatives, see article 2 of title 10; for regulation of pawnbrokers, see article 56 of title 12; for regulation of securities brokers, see article 51 of title 11; for credit unions, see article 30 of title 11.

5-1-203. Jurisdiction and service of process. (1) The court of record of any judicial district in this state may exercise jurisdiction over any creditor with respect to any conduct in this state governed by this code or with respect to any claim arising from a transaction subject to this code. In addition to any other method provided by the Colorado rules of civil procedure or by statute, personal jurisdiction over a creditor may be acquired in a civil action or proceeding instituted in the court of record by the service of process in the manner provided by this section.

(2) If a creditor is not a resident of this state or is a corporation not authorized to do business in this state and engages in any conduct in this state governed by this code or engages in a transaction subject to this code, the creditor may designate an agent upon whom service of process may be made in this state. The agent shall be a resident of this state or a corporation authorized to do business in this state. The designation shall be in writing and filed with the secretary of state. If no designation is made and filed or if process cannot be served in this state upon the designated agent, process may be served upon the secretary of state, but service upon the secretary of state is not effective unless the plaintiff or petitioner forthwith mails a copy of the process and pleading by registered or certified mail to the defendant or respondent at his or her last reasonably ascertainable address. An affidavit of compliance with this section shall be filed with the clerk of the court on or before the return day of the process, if any, or within any further time the court allows.

Source: L. 2000: Entire article R&RE, p. 1183, § 1, effective July 1.

Editor's note: This section is similar to former § 5-1-203, as it existed prior to 2000.

PART 3

DEFINITIONS

5-1-301. General definitions. In addition to definitions appearing in subsequent articles, as used in this code, unless the context otherwise requires:

(1) "Actuarial method" means the method, defined by rules promulgated by the administrator in accordance with article 4 of title 24, C.R.S., of allocating payments made on a debt between the amount financed and finance charge pursuant to which a payment is applied first to the accumulated finance charge and the balance subtracted from, or any deficiency is added to, the unpaid balance of the amount financed.

(2) "Administrator" means the administrator designated in section 5-6-103.

(3) "Agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance.

(4) "Agricultural purpose" means a purpose related to the production, harvest, exhibition, marketing, transportation, processing, or manufacture of agricultural products by a natural person who cultivates, plants, propagates, or nurtures the agricultural products. "Agricultural products" includes agricultural, horticultural, viticultural, and dairy products, livestock, wildlife, poultry, bees, forest products, fish and shellfish, and any products thereof, including processed and manufactured products, and any and all products raised or produced on farms and any processed or manufactured products thereof.

(5) "Amount financed" means the total of the following items to the extent that payment is deferred:

(a) In the case of a sale:

(I) The cash price of the goods, services, or interest in land, less the amount of any down payment whether made in cash or in property traded in; and

(II) The amount actually paid or to be paid by the seller pursuant to an agreement with the buyer to discharge a security interest in or a lien on property traded in;

(b) In the case of a loan:

(I) The net amount paid to, receivable by, or paid or payable for the account of the debtor; and

(II) The amount of any discount excluded from the finance charge described in paragraph (c) of subsection (20) of this section; and

(c) In the case of a sale or loan, to the extent that payment is deferred and the amount is not otherwise included in the cash price:

(I) Any applicable sales, use, excise, or documentary stamp taxes;

(II) Amounts actually paid or to be paid by the creditor for registration, certificate of title, or license fees; and

(III) Additional charges permitted by this code described in section 5-2-202.

(6) "Business day" means any calendar day except Sunday, New Year's day, the third Monday in January observed as the birthday of Dr. Martin Luther King, Jr., Washington-Lincoln day, Memorial day, Independence day, Labor day, Columbus day, Veterans' day, Thanksgiving day, and Christmas day.

(7) (a) "Cash price" means, except as the administrator may otherwise prescribe by rule promulgated in accordance with article 4 of title 24, C.R.S., the price at which goods, services, or an interest in land is offered for sale by the seller to cash buyers in the ordinary course of business and may include the cash price of accessories or related services such as delivery, installation, servicing, repairs, alterations, modifications, and improvements and, if individually itemized, may also include:

(I) Applicable sales, use, and excise and documentary stamp taxes; and

(II) Amounts actually paid or to be paid by the seller for registration, certificate of title, or license fees.

(b) The cash price stated by the seller to the buyer pursuant to the provisions on disclosure contained in section 5-3-101 is presumed to be the cash price.

(8) "Closing costs" with respect to a debt secured by an interest in land includes:

(a) Fees or premiums for title examination, title insurance, or similar purposes including surveys;

(b) Fees for preparation of a deed, settlement statement, or other documents;

(c) Escrows for future payments of taxes and insurance;

(d) Fees for notarizing deeds and other documents;

(e) Appraisal fees; and

(f) Credit reports.

(9) "Conspicuous" means a term or clause that is so written that a reasonable person against whom it is to operate ought to have noticed it. Whether a term or clause is conspicuous or not is for decision by the court. A printed heading in capitals (as: WARRANTY) is conspicuous, and language in the body of the form is conspicuous if it is in larger or other contrasting type or color. In a telegram, any stated term is conspicuous.

(10) "Consumer" means a person other than an organization who is the buyer, lessee, or debtor to whom credit is granted in a consumer credit transaction.

(11) (a) "Consumer credit sale" means, except as provided in paragraph (b) of this subsection (11), a sale of goods, services, a mobile home, or an interest in land in which:

(I) Credit is granted or arranged by a person who regularly engages as a seller in credit transactions of the same kind or pursuant to a seller credit card;

(II) The buyer is a person other than an organization;

(III) The goods, services, mobile home, or interest in land are purchased primarily for a personal, family, or household purpose;

(IV) Either the debt is by written agreement payable in installments or a finance charge is made; and

(V) With respect to a sale of goods or services, the amount financed does not exceed seventy-five thousand dollars.

(b) Unless the sale is made subject to this code by section 5-2-501, "consumer credit sale" does not include:

(I) A sale in which the seller allows the buyer to purchase goods or services pursuant to a lender credit card or similar arrangement;

(II) (A) Except as required by the federal "Truth in Lending Act" or the federal "Consumer Leasing Act" with respect to disclosure contained in section 5-3-101 and consumers' remedies for transactions secured by interests in land as contained in section 5-5-204, a sale of a mobile home or a sale of an interest in land if the finance charge does not exceed twelve percent per year calculated according to the actuarial method on the unpaid balances of the amount financed on the assumption that the debt will be paid according to the agreed terms and will not be paid before the end of the agreed term or, notwithstanding the rate of the finance charge with respect to the sale of an interest in land, the sale is secured by a first mortgage or deed of trust lien against a dwelling to finance the acquisition of that dwelling.

(B) For the purposes of this subparagraph (II), "dwelling" means any improved real property or portion thereof that is used or intended to be used as a residence and contains not more than four dwelling units, and "first mortgage or deed of trust" means a mortgage or deed of trust having priority as a lien over the lien of any other mortgage or deed of trust on the same dwelling and subject to the lien of taxes levied on that dwelling.

(III) A sale for a business, investment, or commercial purpose; or

(IV) A sale primarily for an agricultural purpose.

(12) "Consumer credit transaction" means a consumer credit sale or consumer loan, or a refinancing or consolidation thereof, or a consumer lease.

(13) "Consumer insurance premium loan" means a consumer loan that:

(a) Is made for the sole purpose of financing the payment by or on behalf of an insured of the premium on one or more policies or contracts issued by or on behalf of an insurer;

(b) Is secured by an assignment by the insured to the lender of the unearned premium on the policy or contract; and

(c) Contains an authorization to cancel the policy or contract so financed.

(14) (a) "Consumer lease" means a lease of goods and includes any insurance incidental to the lease and any other services merely incidental to upkeep or repair of the goods:

(I) That a lessor regularly engaged in the business of leasing makes to a person, other than an organization, who takes under the lease primarily for a personal, family, or household purpose;

(II) In which the amount payable under the lease does not exceed seventy-five thousand dollars; and

(III) That is for a term exceeding four months.

(b) "Consumer lease" does not include a lease made pursuant to a lender credit card or similar arrangement.

(15) (a) Except as provided in paragraph (b) of this subsection (15) and except with respect to a "loan primarily secured by an interest in land" as defined in subsection (26) of this section, "consumer loan" means a loan made or arranged by a person regularly engaged in the business of making loans in which:

(I) The consumer is a person other than an organization;

(II) The debt is incurred primarily for a personal, family, or household purpose;

(III) Either the debt is by written agreement payable in installments or a finance charge is made; and

(IV) Either the principal does not exceed seventy-five thousand dollars or the debt is secured by an interest in land.

(b) Unless the loan is made subject to this code by an agreement described in section 5-2-501, "consumer loan" does not include:

(I) A loan for a business, investment, or commercial purpose;

(II) A loan primarily for an agricultural purpose; or

(III) A reverse mortgage as defined in section 11-38-102, C.R.S.

(c) Unless the loan is made subject to this code by an agreement described in section 5-2-501 and except as provided with respect to the disclosure described in section 5-3-101, consumers' remedies for transactions secured by interests in land as described in section 5-5-204, and powers and functions of the administrator under part 1 of article 6 of this title, "consumer loan" does not include a "loan primarily secured by an interest in land" as defined in subsection (26) of this section.

(16) "Credit" means the right granted by a creditor to a consumer to defer payment of debt or to incur debt and defer its payment.

(16.5) "Credit card" means a lender credit card or a seller credit card, except as otherwise provided in this code.

(17) "Creditor" means the seller, lessor, lender, or person who makes or arranges a consumer credit transaction and to whom the transaction is initially payable, or the assignee of a creditor's right to payment, but use of the term does not in itself impose on an assignee any obligation of his or her assignor. In case of credit granted pursuant to a credit card, "creditor" means the card issuer and not another person honoring the credit card.

(18) "Dwelling" means a residential structure or mobile home that contains one to four family housing units or individual units of condominiums or cooperatives.

(19) "Earnings" means compensation paid or payable to an individual or for the individual's account for personal services rendered or to be rendered by the individual, whether denominated as wages, salary, fees, commission, bonus, or otherwise, and includes periodic payments pursuant to a pension, retirement, or disability program.

(20) "Finance charge" means:

(a) The sum of all charges payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or as a condition of the extension of credit, whether paid or payable by the consumer, the creditor, or any other person on behalf of the consumer to the creditor or to a third party, including any of the following types of charges that are applicable:

(I) Interest or any amount payable under a point, discount, or other system of charges, however denominated;

(II) Time-price differential, credit service, service, carrying, or other charge, however denominated;

(III) Premium, or other charge for any guarantee or insurance protecting the creditor against the consumer's default or other credit loss; and

(IV) Charges incurred for investigating the collateral or credit-worthiness of the consumer or for commissions or brokerage for obtaining the credit.

(b) The term does not include charges as a result of default described in section 5-3-302, additional charges described in section 5-2-202, delinquency charges described in section 5-2-203, or deferral charges described in section 5-2-204.

(c) If a creditor makes a loan to a consumer by purchasing or satisfying obligations of the consumer pursuant to a credit card or similar arrangement and the purchase or satisfaction is made at less than the face amount of the obligation, the discount is not part of the finance charge.

(21) "Goods" includes goods not in existence at the time the transaction is entered into and merchandise certificates but excludes money, chattel paper, documents of title, and instruments.

(22) "Investment purpose" means that the primary purpose of the credit sale or loan is for future financial gain rather than for a present personal, family, or household use.

(23) "Lender" includes an assignee of the lender's right to payment, unless otherwise provided in this code, but use of the term does not in itself impose on an assignee any obligation of the lender with respect to events occurring before the assignment.

(24) "Lender credit card or similar arrangement" means an arrangement or loan agreement, other than a seller credit card, pursuant to which a lender gives a consumer the privilege of using a credit card, letter of credit, or other credit confirmation or identification in transactions out of which debt arises:

(a) By the lender's honoring a draft or similar order for the payment of money drawn or accepted by the consumer;

(b) By the lender's payment or agreement to pay the consumer's obligations; or

(c) By the lender's purchase from the obligee of the consumer's obligations.

(25) "Loan" includes:

(a) Except as otherwise provided in paragraph (b) of this subsection (25):

(I) The creation of debt by the lender's payment of or agreement to pay money to the consumer or to a third party for the account of the consumer;

(II) The creation of debt by a credit to an account with the lender upon which the consumer is entitled to draw immediately;

(III) The creation of debt pursuant to a lender credit card in any manner, including a cash advance or the card issuer's honoring a draft or similar order for the payment of money drawn or accepted by the consumer, paying or agreeing to pay the consumer's obligation, or purchasing or otherwise acquiring the consumer's obligation from the obligee or his or her assignees;

(IV) The forbearance of debt arising from a loan; and

(V) The creation of debt by a cash advance to a consumer pursuant to a seller credit card.

(b) "Loan" does not include:

(I) A card issuer's payment or agreement to pay money to a third person for the account of a consumer if the debt of the consumer arises from a sale or lease and results from use of a seller credit card; or

(II) The forbearance of debt arising from a sale or lease.

(26) (a) "Loan primarily secured by an interest in land" means a consumer loan secured by a mobile home or primarily secured by an interest in land if, at the time the loan is made the value of the collateral is substantial in relation to the amount of the loan, and:

(I) The rate of the finance charge does not exceed twelve percent per year calculated according to the actuarial method on the unpaid balances of the principal on the assumption that the debt will be paid according to the agreed terms and will not be paid before the end of the agreed term; or

(II) Notwithstanding the rate of the finance charge, and other than a precomputed loan as defined in subsection (35) of this section, the loan is secured by a first mortgage or deed of trust lien against a dwelling to:

(A) Finance the acquisition of that dwelling; or

(B) To refinance, by amendment, payoff, or otherwise, an existing loan made to finance the acquisition of that dwelling, including a refinance loan providing additional sums for any purpose whether or not related to acquisition or construction.

(b) As to any refinance loan in the form of a revolving loan account that is in whole or in part for purposes other than acquisition or construction, section 5-3-103 shall apply.

(c) With respect to loans secured by a first mortgage or deed of trust lien against a dwelling to refinance an existing loan to finance the acquisition of the dwelling and providing additional sums for any other purpose that are not subject to this code pursuant to paragraph (a) of this subsection (26), the lender shall disclose to the consumer that the refinance loan creates a lien against the dwelling or property and that the limits set forth in

section 5-5-112 on the amount of attorney fees that a lender may charge the consumer are not applicable.

(d) For purposes of this subsection (26):

(I) A "loan secured by a first mortgage or deed of trust lien against a dwelling to finance the acquisition of the dwelling" includes a loan secured by a first mortgage or deed of trust lien against a dwelling to finance the original construction of such dwelling or to refinance any such construction loan;

(II) "Dwelling" means any improved real property, or portion thereof, that is used or intended to be used as a residence and contains not more than four dwelling units; and

(III) "First mortgage or deed of trust" means a mortgage or deed of trust having priority as a lien over the lien of any other mortgage or deed of trust on the same dwelling and subject to the lien of taxes levied on that dwelling.

(27) "Material disclosures" means the disclosure, as required by this code, of the annual percentage rate, the method of determining the finance charge and the balance upon which a finance charge will be imposed, the amount of the finance charge, the amount to be financed, the total of payments, the number and amount of payments, and the due dates or periods of payments scheduled to repay the indebtedness.

(28) "Merchandise certificate" means a writing not redeemable in cash and usable in its face amount in lieu of cash in exchange for goods or services.

(29) "Mobile home" means a dwelling that is built on a chassis designed for long-term residential occupancy, that is capable of being installed in a permanent or semi-permanent location, with or without a permanent foundation, and with major appliances and plumbing, gas, and electrical systems installed but needing the appropriate connections to make them operable, and that may be occasionally drawn over the public highways, by special permit, as a unit or in sections to its permanent or semi-permanent location.

(30) "Official fees" means:

(a) Fees and charges prescribed by law that actually are or will be paid to public officials for determining the existence of or for perfecting, releasing, or satisfying a security interest related to a consumer credit transaction; or

(b) Premiums payable for insurance in lieu of perfecting a security interest otherwise required by the creditor in connection with the consumer credit transaction if the premium does not exceed the fees and charges described in paragraph (a) of this subsection (30) that would otherwise be payable.

(31) "Organization" means a corporation, limited liability company, government or governmental subdivision or agency, trust, estate, partnership, limited liability partnership, cooperative, or association.

(32) "Payable in installments" means that payment is required or permitted by agreement to be made in more than four periodic payments, excluding a down payment. If any periodic payment other than the down payment under an agreement requiring or permitting two or more periodic payments is more than twice the amount of any other periodic payment, excluding the down payment, the consumer credit transaction is "payable in installments".

(33) "Person" includes a natural person or an individual and an organization.

(34) (a) "Person related to" means, with respect to an individual, the spouse of the individual; a brother, brother-in-law, sister, or sister-in-law of the individual; an ancestor or lineal descendant of the individual or the individual's spouse; and any other relative, by blood or marriage, of the individual or the individual's spouse who shares the same home with the individual.

(b) "Person related to" means, with respect to an organization, a person directly or indirectly controlling, controlled by, or under common control with the organization; an officer or director of the organization or a person performing similar functions with respect to the organization or to a person related to the organization; the spouse of a person related to the organization; and a relative by blood or marriage of a person related to the organization who shares the same home with such person.

(35) "Precomputed" means a consumer credit sale or consumer loan in which the debt is expressed as a sum comprising the amount financed and the amount of the finance charge computed in advance or in which any portion of the finance charge is prepaid and the

amount of that portion of the finance charge either computed in advance or prepaid constitutes more than one-half of the total finance charge applicable to the consumer credit sale or consumer loan.

(36) "Presumed" or "presumption" means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced that would support a finding of its nonexistence.

(37) "Regularly" has the same meaning as stated in the federal "Truth in Lending Act" and the federal "Consumer Leasing Act".

(38) "Revolving credit" means an arrangement pursuant to which:

(a) A creditor may permit a consumer, from time to time, to purchase or lease on credit from the creditor or to obtain loans from the creditor;

(b) The amounts financed and the finance and other appropriate charges are debited to an account;

(c) The finance charge, if made, is computed on the account periodically; and

(d) Either the consumer has the privilege of paying in full or in installments or the creditor periodically imposes charges computed on the account for delaying payment and permits the consumer to continue to purchase or lease on credit.

(39) "Sale of goods" includes any agreement in the form of a bailment or lease of goods if the bailee or lessee agrees to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the goods involved and it is agreed that the bailee or lessee will become, or for no other or a nominal consideration has the option to become, the owner of the goods upon full compliance with his or her obligations under the agreement.

(40) "Sale of an interest in land" includes a lease in which the lessee has an option to purchase the interest and all or a substantial part of the rental or other payments previously made by him are applied to the purchase price.

(41) "Sale of services" means furnishing or agreeing to furnish services and includes making arrangements to have services furnished by another.

(42) "Seller", except as otherwise provided, includes an assignee of the seller's right to payment, but use of the term does not in itself impose on an assignee any obligation of the seller with respect to events occurring before the assignment.

(43) "Seller credit card" means an arrangement pursuant to which a person gives to a buyer or lessee the privilege of using a credit card, letter of credit, or other credit confirmation or identification primarily for the purpose of purchasing or leasing goods or services from that person or from that person and any other person.

(44) "Services" includes:

(a) Work, labor, and other personal services;

(b) Privileges with respect to transportation, hotel and restaurant accommodations, education, entertainment, recreation, physical culture, hospital accommodations, funerals, cemetery accommodations, and the like; and

(c) Insurance provided by a person other than the insurer.

(45) "Supervised financial organization" means a person, other than an insurance company or other organization primarily engaged in an insurance business:

(a) Organized, chartered, or holding an authorization certificate under the laws of any state or of the United States that authorize the person to make loans and to receive deposits, including a savings, share, certificate, or deposit account; and

(b) Subject to supervision by an official or agency of any state or of the United States.

(46) "Supervised lender" means a person authorized to make or take assignments of supervised loans under a license issued by the administrator or as a supervised financial organization.

(47) "Supervised loan" means a consumer loan, including a loan made pursuant to a revolving credit account, in which the rate of the finance charge exceeds twelve percent per year as determined according to the provisions on finance charges contained in section 5-2-201.

(48) "Written" or "in writing" means any record conveying information and that is in a form the consumer may retain, or is capable of being displayed in visual text in a form the consumer may retain, including paper, electronic, digital, magnetic, optical, and electromagnetic.

Source: L. 2000: Entire article R&RE, p. 1183, § 1, effective July 1; (17) amended, p. 443, § 2, effective July 1. **L. 2001:** (1), (5)(b)(II), (15)(a)(III), and (26)(c) amended, p. 27, § 1, effective March 9. **L. 2003:** (16.5) added, p. 1892, § 1, effective July 1. **L. 2004:** (11)(b)(II)(A) and (15)(c) amended, p. 1187, § 6, effective August 4.

Editor's note: (1) This section is similar to former § 5-1-301, as it existed prior to 2000.
(2) Subsection (17) was amended in Senate Bill 00-144. Those amendments were duplicated in § 5-1-301 (45)(a) as contained in the repeal and reenactment of article 1 of title 5 by House Bill 00-1185.

Cross references: (1) For additional definitions of the days under subsection (6) of this section, see § 24-11-101.
(2) For the definitions and federal statutory cites of the "Truth in Lending Act" and the "Consumer Leasing Act", see § 5-1-302.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971). For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982). For article, "Colorado Usury: The Sequel - Parts I and II", see 23 Colo. Law. 565 and 829 (1994). For article, "The Colorado Equity Protection Act: A Response to Predatory Lending Practices", see 32 Colo. Law. 79 (April 2003).

Subdivision of property and sale of lots held to be "credit transactions of the same kind" and therefore "consumer credit sales" under subsection (1)(a). Varady v. White, 661 P.2d 284 (Colo. App. 1982) (decided prior to 2000 repeal and reenactment).

The sale and assignment of a taxpayer's right to receive an income tax refund from the internal revenue service constitutes a loan subject to the Uniform Consumer Credit Code. State ex rel. Salazar v. The Cash Now Store, Inc., 31 P.3d 161 (Colo. 2001) (decided under former § 5-3-104 as it existed prior to the 2000 repeal and reenactment).

Where the loan was for taxes and business expenses incurred by an auto repair garage, it was frivolous to argue that the loan was personal because it preserved the business for plaintiff's son. Nienke v. Naiman Group, Ltd., 857 P.2d 446 (Colo. App. 1992) (decided prior to 2000 repeal and reenactment).

Transactions were consumer credit sales, not consumer loans, where transactions involved the purchase of vehicles from a used care dealership, the arrangement of financing by the dealership, the financing of the purchases by a third party lender, and the assignment of the dealer's right to payment from the purchasers to the third party lender, and where the purchasers never directly received money from the lender. De La Rosa v. Western Funding, Inc., 24 P.3d 637 (Colo. App. 2001).

Applied in Empire Sav., Bldg. & Loan Ass'n v. Otero Sav. & Loan Ass'n, 640 P.2d 1151 (Colo. 1982) (decided prior to 2000 repeal and reenactment).

5-1-302. Definitions - federal "Truth in Lending Act" and federal "Consumer Leasing Act". In this code, federal "Truth in Lending Act", 15 U.S.C. sec. 1601 et seq., and federal "Consumer Leasing Act", 15 U.S.C. sec. 1667 et seq., mean chapters of the "Consumer Credit Protection Act" (Public Law 90-321; 82 Stat. 146), as amended from time to time, and include regulations issued pursuant to those acts.

Source: L. 2000: Entire article R&RE, p. 1194, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 5-1-302, as it existed prior to 2000.
(2) "Consumer Leasing Act", referred to throughout this title, means the federal "Consumer Leasing Act of 1976", Pub.L. 94-240.

5-1-303. Index of definitions in code. Definitions in this code and the sections in which they appear are:

"Actuarial method"	section 5-1-301 (1)
"Administrator"	sections 5-1-301 (2) and 5-6-103

"Agreement"	section 5-1-301 (3)
"Agricultural purpose"	section 5-1-301 (4)
"Amount financed"	section 5-1-301 (5)
"Business day"	section 5-1-301 (6)
"Cash price"	section 5-1-301 (7)
"Closing costs"	section 5-1-301 (8)
"Conspicuous"	section 5-1-301 (9)
"Consumer"	section 5-1-301 (10)
"Consumer credit insurance"	section 5-4-103 (1)
"Consumer credit sale"	section 5-1-301 (11)
"Consumer credit transaction"	section 5-1-301 (12)
"Consumer insurance premium loan"	section 5-1-301 (13)
"Consumer lease"	section 5-1-301 (14)
"Consumer loan"	section 5-1-301 (15)
"Credit"	section 5-1-301 (16)
"Credit card bank or financial institution"	section 5-2-213 (1)
"Creditor"	section 5-1-301 (17)
"Credit Insurance Act"	section 5-4-103 (2)
"Dwelling"	section 5-1-301 (18)
"Earnings"	section 5-1-301 (19)
"Federal 'Truth in Lending Act'" and "Federal 'Consumer Leasing Act'"	section 5-1-302
"Finance charge"	section 5-1-301 (20)
"Goods"	section 5-1-301 (21)
"Home solicitation sale"	section 5-3-401
"Investment purpose"	section 5-1-301 (22)
"Lender"	section 5-1-301 (23)
"Lender credit card or similar arrangement"	section 5-1-301 (24)
"Loan"	section 5-1-301 (25)
"Loan primarily secured by an interest in land"	section 5-1-301 (26)
"Material disclosures"	section 5-1-301 (27)
"Merchandise certificate"	section 5-1-301 (28)
"Mobile home"	section 5-1-301 (29)
"Official fees"	section 5-1-301 (30)
"Organization"	section 5-1-301 (31)
"Payable in installments"	section 5-1-301 (32)
"Person"	section 5-1-301 (33)
"Person related to"	section 5-1-301 (34)
"Precomputed"	section 5-1-301 (35)
"Presumed" or "Presumption"	section 5-1-301 (36)
"Receive"	section 5-1-201 (10)
"Regularly"	section 5-1-301 (37)
"Residence"	section 5-1-201 (6)
"Revolving credit"	section 5-1-301 (38)
"Sale of goods"	section 5-1-301 (39)
"Sale of an interest in land"	section 5-1-301 (40)
"Sale of services"	section 5-1-301 (41)
"Seller"	section 5-1-301 (42)
"Seller credit card"	section 5-1-301 (43)
"Services"	section 5-1-301 (44)
"Supervised financial organization"	section 5-1-301 (45)
"Supervised lender"	section 5-1-301 (46)
"Supervised loan"	section 5-1-301 (47)
"Written" or "In writing"	section 5-1-301 (48)

Source: L. 2000: Entire article R&RE, p. 1194, § 1, effective July 1.

Editor's note: This section is similar to former § 5-1-303, as it existed prior to 2000.

ARTICLE 2

Finance Charges and Related Provisions

Editor's note: This article was numbered as article 2 of chapter 73, C.R.S. 1963. This title was repealed and reenacted in 1971, and this article was subsequently repealed and reenacted in 2000, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 2000, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume and the editor's note following the title heading. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated. For a detailed comparison of this article, see the comparative tables located in the back of the index.

PART 1

GENERAL PROVISIONS

5-2-101. Short title. This article shall be known and may be cited as "Uniform Consumer Credit Code - Finance Charges and Related Provisions".

Source: L. 2000: Entire article R&RE, p. 1195, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-101, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "The Uniform Small Loan Law", see 6 Dicta 5 (1929). For article, "Professional Ethics", see 9 Dicta 317 (1932). For article, "Installment Selling in Colorado and Needed Legislation", see 29 Dicta 81 (1952). For note, "Colorado Interest Law", see 34 Dicta 398 (1957). For article, "Highlights of 1955 Colorado Legislative Session — Consumer Finance Act", see 28 Rocky Mt. L. Rev. 77 (1955). For article, "One Year Review of Real Property", see 36 Dicta 57 (1959). For article, "One Year Review of Contracts", see 38 Dicta 161 (1961). For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For article, "The Plight of the Consumer in the Uniform Consumer Credit Code", see 48 Den. L.J. 1 (1971). For article, "Legislative Overview of the Uniform Consumer Credit Code: A 1971 Perspective", see 48 Den. L.J. 27 (1971).

Annotator's note. (1) For cases construing prior provisions (§ 73-2-1 et seq., C.R.S. 1963, § 73-3-1 et seq., CRS 53) governing loans over $15,000, see Waggener v. Holt Chew Motor Co., 130 Colo. 294, 274 P.2d 968 (1954); Siegal v. Lechler, 130 Colo. 338, 275 P.2d 949 (1954); Camellia Cleaners, Inc. v. Siegal, 131 Colo. 570, 283 P.2d 1083 (1955); Horlbeck v. Walther, 133 Colo. 19, 291 P.2d 688 (1955); Denning v. A.D. Wilson & Co., 137 Colo. 372, 326 P.2d 77 (1958); Von Reisen v. Greeley Fin. Co., 142 Colo. 210, 350 P.2d 340 (1960); Theodore Roosevelt Agency, Inc. v. GMAC, 156 Colo. 237, 398 P.2d 965 (1965), Dennis v. Bradbury, 236 F. Supp. 683 (D. Colo. 1964), aff'd and reh'g denied, 368 F.2d 905 (1966); Lederman Enterprises, Inc. v. Westinghouse Credit Corp., 347 F. Supp. 1291 (D. Colo. 1972).

(2) For case construing prior provisions (§ 73-3-1 et seq., C.R.S. 1963, § 73-4-1 et seq., CRS 53) governing loans of $15,000 or less, see Klipping v. McCauley, 143 Colo. 444, 354 P.2d 167 (1960).

(3) For cases construing prior provisions (§ 73-2-1 et seq., CRS 53; CSA, C. 88, §§ 22 through 44; and laws antecedent to CSA, C. 88, §§ 22 through 44) governing small loans ($300 or less), see Newman v. People, 23 Colo. 300, 47 P. 278 (1896); Lamar Canal Co. v. Amity Land & Irrigation Co., 26 Colo. 370, 58 P. 600 (1899); People ex rel. Colo. Bar Ass'n v. Erbaugh, 42 Colo. 480, 94 P. 349 (1908); Cavanaugh v. People, 61 Colo. 292, 157 P. 200 (1916); Warner v. People, 71 Colo. 559, 208 P. 459 (1922); Beneficial Loan & Inv. Co. v. Ira, 75 Colo. 379, 226 P.136 (1924); Rice v. Franklin Loan & Fin. Co., 82 Colo. 163, 258 P. 223 (1927); Angleton v. Franklin Fin. Co., 88 Colo. 322, 295 P. 797 (1931); Gilbert v. Hudgens, 92 Colo. 571, 22 P.2d 858 (1933); Gronert v. People, 95 Colo. 508, 37 P.2d 396 (1934); Furlong v. People, 95 Colo. 571, 37 P.2d 1119 (1934); Daniels v. Fenton, 97 Colo. 409, 50 P.2d 62 (1935); Dowd v. Labor Fin. Corp., 100 Colo. 512, 69 P.2d 305 (1937); Siebers v. Labor Fin. Corp., 100 Colo. 40, 64 P.2d 1263 (1937); Waddell v. Traylor, 99 Colo. 576, 64 P.2d 1273 (1937); Siebers v. Disque, 102 Colo. 39, 76 P.2d 1108 (1938); Personal Fin. Co. v. Baker, 105 Colo. 1, 94 P.2d 460 (1939); Personal Fin. Co. v. Day, 126 F.2d 281 (10th Cir. 1942); Ray v. City & County of Denver, 109 Colo. 74, 121 P.2d 886 (1942); Sullivan v. Siegal, 125 Colo. 544, 245 P.2d 860 (1952).

5-2-102. Scope. For purposes of this article, "consumer credit transaction" applies to consumer loans, including supervised loans, consumer credit sales, and refinancing and consolidations of these transactions but does not include consumer leases except for the charges and procedures in sections 5-2-202 and 5-2-203. The provisions concerning credit card surcharges contained in section 5-2-212 apply to all sales and leases.

Source: L. 2000: Entire article R&RE, p. 1195, § 1, effective July 1. **L. 2009:** Entire section amended, (HB 09-1141), ch. 41, p. 157, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-102, as it existed prior to 2000.

PART 2

MAXIMUM FINANCE CHARGES AND OTHER FEES AND CHARGES

5-2-201. Finance charge for consumer credit transactions. (1) With respect to a consumer loan other than a supervised loan, including a revolving loan, a lender may

contract for and receive a finance charge calculated according to the actuarial method not exceeding twelve percent per year on the unpaid balance of the amount financed.

(2) With respect to a supervised loan or a consumer credit sale, except for a loan or sale pursuant to a revolving account, a supervised lender or seller may contract for and receive a finance charge, calculated according to the actuarial method, not exceeding the equivalent of the greater of either of the following:

(a) The total of:

(I) Thirty-six percent per year on that part of the unpaid balances of the amount financed that is one thousand dollars or less;

(II) Twenty-one percent per year on that part of the unpaid balances of the amount financed that is more than one thousand dollars but does not exceed three thousand dollars; and

(III) Fifteen percent per year on that part of the unpaid balances of the amount financed that is more than three thousand dollars; or

(b) Twenty-one percent per year on the unpaid balances of the amount financed.

(3) (a) Except as provided in paragraph (b) of this subsection (3), the finance charge for a supervised loan or consumer credit sale pursuant to a revolving credit account, calculated according to the actuarial method, may not exceed twenty-one percent per year on the unpaid balance of the amount financed.

(b) Notwithstanding paragraph (a) of this subsection (3), if there is an unpaid balance on the date as of which the finance charge is applied, the creditor may contract for and receive a minimum finance charge not exceeding fifty cents.

(4) (a) Except as provided in paragraph (b) of this subsection (4), this section does not limit or restrict the manner of contracting for the finance charge, whether by way of add-on, discount, single annual percentage rate, or otherwise, so long as the rate of the finance charge does not exceed that permitted by this section.

(b) A seller or lender may contract for the payment by a consumer of a prepaid finance charge. In addition to any other disclosure required by this code, a seller or lender shall disclose to the consumer the amount of any such prepaid finance charge.

(c) If the consumer credit transaction is precomputed:

(I) The finance charge may be calculated on the assumption that all scheduled payments will be made when due;

(II) The effect of prepayment is governed by the provisions on rebate upon prepayment contained in section 5-2-211.

(5) Except as provided in subsection (8) of this section, the term of a consumer credit transaction, for the purposes of this section, commences on the date the consumer credit transaction is made. Differences in the lengths of months are disregarded and a day may be counted as one-thirtieth of a month. Subject to classifications and differentiations the creditor may reasonably establish, a part of a month in excess of fifteen days may be treated as a full month if periods of fifteen days or less are disregarded and that procedure is not consistently used to obtain a greater yield than would otherwise be permitted.

(6) Subject to classifications and differentiations the creditor may reasonably establish, the creditor may make the same finance charge on all amounts financed within a specified range. A finance charge so made does not violate this section if:

(a) When applied to the median amount within each range, it does not exceed the maximum permitted in this section; and

(b) When applied to the lowest amount within each range, it does not produce a rate of finance charge exceeding the rate calculated according to paragraph (a) of this subsection (6) by more than eight percent of such rate.

(7) Notwithstanding the provisions of subsections (1), (2), and (3) of this section, the creditor, in connection with a consumer credit transaction other than a deferred deposit loan as defined in section 5-3.1-102 (3) or one pursuant to a revolving credit account, may contract for and receive a minimum loan finance charge of not more than twenty-five dollars.

(8) With respect to a consumer insurance premium loan, the term of the loan commences on the earliest inception date of a policy or contract of insurance on which payment of the premium is financed by the loan.

Source: L. 2000: Entire article R&RE, p. 1196, § 1, effective July 1. **L. 2001:** (4)(b) amended, p. 28, § 2, effective March 9. **L. 2003:** (7) amended, p. 1892, § 2, effective July 1.

Editor's note: This section is similar to former § 5-2-201, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971). For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982).

Defendant was entitled to charge 21% interest with respect to installment payments on the purchase of vehicles from a used-car dealership. Transaction was a consumer credit sale, not a consumer loan, so defendant who was an assignee of the dealership was legally entitled to charge 21% interest under this section. De La Rosa v. Western Funding, Inc., 24 P.3d 637 (Colo. App. 2001).

5-2-202. Additional charges. (1) In addition to the finance charge permitted by this article and in a consumer lease, a creditor may contract for and receive the following additional charges in connection with a consumer credit transaction:

(a) Official fees and taxes;

(b) Charges for insurance as described in subsection (3) of this section;

(c) Annual charges, payable in advance, for the privilege of using a credit card or similar arrangement;

(d) Charges for other benefits conferred on the consumer, including insurance, if the benefits are of value to the consumer and if the charges are reasonable in relation to the benefits, are of a type that is not for credit, and are authorized as permissible additional charges by rule adopted by the administrator;

(e) The following charges if agreed to by the parties:

(I) A charge, not to exceed the greater of two dollars or two and one-half percent of the amount advanced, for each cash advance transaction made pursuant to a credit card; and

(II) A fee, not to exceed twenty-five dollars, assessed upon return or dishonor of a check or other instrument tendered as payment.

(2) No finance charge may be assessed on any charge listed in paragraph (e) of subsection (1) of this section.

(3) An additional charge may be made for insurance written in connection with the transaction, other than insurance protecting the creditor against the consumer's default or other credit loss, if:

(a) With respect to insurance against loss of or damage to property or against liability, the creditor furnishes a clear and specific statement in writing to the consumer setting forth the cost of the insurance if obtained from or through the creditor and stating that the consumer may choose the person through whom the insurance is to be obtained; and

(b) With respect to consumer credit insurance providing life, accident, or health coverage, the insurance coverage is not a factor in the approval by the creditor of the extension of credit and this fact is clearly disclosed in writing to the consumer and if, in order to obtain the insurance in connection with the extension of credit, the consumer gives specific affirmative written indication of the consumer's desire to do so after written disclosure to the consumer of the cost thereof.

(4) With respect to a debt secured by an interest in land, bona fide and reasonable closing costs described in section 5-1-301 (8) are additional charges.

Source: L. 2000: Entire article R&RE, p. 1197, § 1, effective July 1. **L. 2002:** (1)(b) amended, p. 1012, § 2, effective June 1. **L. 2009:** IP(1) amended, (HB 09-1141), ch. 41, p. 157, § 2, effective July 1.

Editor's note: This section is similar to former § 5-2-202, as it existed prior to 2000.

ANNOTATION

National Bank Act preempts this section to the extent that an out-of-state national bank may "export" a favorable interest rate from the state in which it is located. Copeland v. MBNA Am., N.A., 883 P.2d 564 (Colo. App. 1994) (decided prior to 2000 repeal and reenactment).

Applied in Empire Sav., Bldg. & Loan Ass'n v. Otero Sav. & Loan Ass'n, 640 P.2d 1151 (Colo. 1982) (decided prior to 2000 repeal and reenactment).

5-2-203. Delinquency charges. (1) With respect to a consumer credit transaction, the parties may contract for a delinquency charge on any installment or minimum payment not paid in full within ten days after its scheduled due date in an amount not exceeding:

(a) Fifteen dollars for a transaction not secured by an interest in land; except that, if the transaction is precomputed, the amount may not exceed the greater of fifteen dollars or the deferral charge described in section 5-2-204 (1) that would be permitted to defer the unpaid amount of the installment for the period that it is delinquent; or

(b) Five percent of the unpaid amount of the installment or minimum payment due for a transaction secured by an interest in land.

(2) A delinquency charge under this section may be collected only once on an installment or minimum payment however long it remains in default. No delinquency charge may be collected if the installment or minimum payment has been deferred and a deferral charge described in section 5-2-204 has been paid or incurred until ten days after the deferred due date. A delinquency charge may be collected at the time it accrues or at any time thereafter.

(3) No delinquency charge may be collected on an installment or minimum payment that is paid in full within ten days after its scheduled installment due date even though an earlier maturing installment, minimum payment, or a delinquency charge on an earlier installment or minimum payment may not have been paid in full. For purposes of this subsection (3), payments are applied first to current installments or minimum payments due and then to delinquent installments or minimum payments due.

(4) (a) A creditor who has imposed a delinquency charge shall notify the consumer in writing of the amount of the delinquency charge assessed as follows:

(I) Before the due date of the next scheduled payment;

(II) If the creditor provides the consumer with periodic statements for each installment, on or with the next periodic statement provided to the consumer after the delinquency charge has been assessed; or

(III) For a revolving credit account for which a credit card is issued and that is not secured by an interest in land, before, on, or with the next periodic statement after the delinquency charge has been assessed.

(b) A creditor shall not assess a delinquency charge unless the delinquency charge is assessed within thirty days after the scheduled due date of any installment not paid in full or, for a revolving credit account for which a credit card is issued and that is not secured by an interest in land, within ninety days after the scheduled due date of the delinquent minimum payment.

(5) No finance charge may be assessed on any delinquency charge. For purposes of this section, for revolving credit, an installment is the minimum payment that the debtor is required to make during any billing cycle excluding any past-due amount from any previous billing cycle.

(6) If two installments or parts thereof of a precomputed transaction are in default for ten days or more, the creditor may elect to convert the transaction from a precomputed transaction to one in which the finance charge is based on unpaid balances, and the terms of the converted transaction shall be no less favorable to the consumer than the terms of the original transaction. In this event the creditor shall make a rebate pursuant to the provisions on rebate upon prepayment contained in section 5-2-211 as of the maturity date of the first delinquent installment and thereafter may make a finance charge as authorized by the provisions on finance charges. The amount of the rebate shall not be reduced by the amount of any permitted minimum charge described in section 5-2-201. If the creditor proceeds

under this subsection (6), any delinquency or deferral charges made with respect to installments due at or after the maturity date of the first delinquent installment shall be rebated and no further delinquency or deferral charges shall be made.

Source: L. 2000: Entire article R&RE, p. 1198, § 1, effective July 1. **L. 2007:** (4) amended, p. 842, § 1, effective May 14.

Editor's note: This section is similar to former § 5-2-203, as it existed prior to 2000.

ANNOTATION

Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 preempted plaintiff's claims against a Delaware bank that the bank's late charges violated this section and § 5-5-202. Stoorman v. Greenwood Trust Co., 888 P.2d 289 (Colo. App. 1994) (decided under law in effect prior to the 2000 repeal and reenactment).

"Interest" under § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 includes late fees and, therefore, Colorado law is preempted by the federal law with respect to late charges. Stoorman v. Greenwood Trust Co., 888 P.2d 289 (Colo. App. 1994); Richardson v. Citibank (S.D.), N.A., 908 P.2d 532 (Colo. 1995); Smiley v. Citibank (S.D.), 517 U.S. 735 (1996) (decided under law in effect prior to the 2000 repeal and reenactment).

Plaintiff's common law challenges were preempted by § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 since that law creates an exclusive federal remedy and an exclusive federal remedy is inconsistent with the idea that a plaintiff can seek relief under state common law theories. Stoorman v. Greenwood Trust Co., 888 P.2d 289 (Colo. App. 1994) (decided under law in effect prior to the 2000 repeal and reenactment).

National Bank Act preempts this section to the extent that an out-of-state national bank may "export" a favorable interest rate from the state in which it is located. Copeland v. MBNA Am., N.A., 883 P.2d 564 (Colo. App. 1994) (decided under law in effect prior to the 2000 repeal and reenactment).

Section 86 of the National Bank Act of 1982 authorizes a national bank to charge interest at the rate allowed by the laws of the state where the bank is located. Copeland v. MBNA Am. Bank, N.A., 907 P.2d 87 (Colo. 1995) (decided under law in effect prior to 1993 amendment).

"Interest" under § 85 of the National Bank Act of 1982, includes late payment fees and, therefore, a national bank located in Delaware is authorized to charge such fees to a Colorado cardmember despite the fact that Colorado law prohibits late payment fees in addition to finance charges. Copeland v. MBNA Am. Bank, N.A., 907 P.2d 87 (Colo. 1995) (decided under law in effect prior to 1993 amendment).

5-2-204. Deferral charges. (1) With respect to a precomputed consumer credit transaction, the parties before or after default may agree in writing to a deferral of all or part of one or more unpaid installments, and the creditor may make and collect a charge not exceeding the rate previously stated to the consumer pursuant to the provisions on disclosure contained in section 5-3-101 applied to the amount or amounts deferred for the period of deferral calculated without regard to differences in the lengths of months, but proportionally for a part of a month, counting each day as one-thirtieth of a month. A deferral charge may be collected at the time it is assessed or at any time thereafter.

(2) The creditor, in addition to the deferral charge, may make appropriate additional charges described in section 5-2-202, and the amount of these charges that is not paid in cash may be added to the amount deferred for the purpose of calculating the deferral charge.

(3) The parties may agree in writing at the time of a precomputed consumer credit transaction that, if an installment is not paid within ten days after its due date, the creditor may unilaterally grant a deferral and make charges as provided in this section. No deferral charge may be made for a period after the date that the creditor elects to accelerate the maturity of the agreement.

(4) A delinquency charge made by the creditor on an installment may not be retained if a deferral charge is made pursuant to this section with respect to the period of delinquency.

(5) A deferral charge made according to this section is earned pro rata during the period in which no installment is scheduled to be paid by reason of the deferral and is fully earned on the last day of that period.

Source: L. 2000: Entire article R&RE, p. 1200, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-204, as it existed prior to 2000.

5-2-205. Finance charge on refinancing. (1) With respect to a consumer credit transaction, the creditor may by agreement with the consumer refinance the unpaid balance and may contract for and receive a finance charge based on the amount financed resulting from the refinancing at a rate not exceeding that permitted by the provisions on finance charges. For the purpose of determining the finance charge permitted, the amount financed resulting from the refinancing comprises the following:

(a) If the transaction was not precomputed, the total of the unpaid balance and the accrued charges on the date of the refinancing, or, if the transaction was precomputed, the amount that the consumer would have been required to pay upon prepayment pursuant to the provisions on rebate upon prepayment contained in section 5-2-211 on the date of refinancing; except that, for the purpose of computing this amount, no minimum charge described in section 5-2-201 shall be allowed; and

(b) Appropriate additional charges described in section 5-2-202, payment of which is deferred.

Source: L. 2000: Entire article R&RE, p. 1200, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-205, as it existed prior to 2000.

5-2-206. Finance charge on consolidation. If a consumer owes an unpaid balance to a creditor with respect to a consumer credit transaction and becomes obligated on another consumer credit transaction with the same creditor, the parties may agree to a consolidation resulting in a single schedule of payments. If the previous consumer credit transaction was not precomputed, the parties may agree to add the unpaid amount of the amount financed and accrued charges on the date of consolidation to the amount financed with respect to the subsequent consumer credit transaction. If the previous consumer credit transaction was precomputed, the parties may agree to refinance the unpaid balance pursuant to the provisions on refinancing contained in section 5-2-205 and to consolidate the amount financed resulting from the refinancing by adding it to the amount financed with respect to the subsequent consumer credit transaction. In either case, the creditor may contract for and receive a finance charge based on the aggregate amount financed resulting from the consolidation at a rate not in excess of that permitted by the provisions on finance charges.

Source: L. 2000: Entire article R&RE, p. 1201, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-205, as it existed prior to 2000.

5-2-207. Prepaid finance charge. (1) Subject to the provisions of subsection (2) of this section, a creditor may contract for the payment by the consumer of a prepaid finance charge; except that the total finance charge contracted for and received by the creditor shall not exceed that permitted for consumer credit transactions.

(2) With respect to a refinancing pursuant to section 5-2-205 or consolidation pursuant to section 5-2-206 of a previous consumer credit transaction for which a prepaid finance charge was imposed, if said refinancing or consolidation is consummated within one year after the previous transaction, a new prepaid finance charge may be imposed:

(a) Only on that portion of the aggregate amount financed resulting from the refinancing or consolidation that exceeds the unpaid balance of the previous transaction determined in accordance with the provisions of section 5-2-205 or section 5-2-206, whichever is appropriate; or

(b) On the aggregate amount financed resulting from the refinancing or consolidation; except that any unearned portion of the prepaid finance charge imposed in connection with

the previous transaction shall be rebated to the consumer in accordance with the actuarial method as defined in section 5-1-301 and applicable rules adopted by the administrator.

Source: L. 2000: Entire article R&RE, p. 1201, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-206.5, as it existed prior to 2000.

5-2-208. Conversion to revolving account. The parties may agree to add to a revolving account the unpaid balance of a consumer credit transaction not made pursuant to a revolving account. The unpaid balance is an amount equal to the amount financed determined according to the provisions on refinancing contained in section 5-2-205.

Source: L. 2000: Entire article R&RE, p. 1201, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-207 (5), as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971). For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982).

5-2-209. Advances to perform covenants of consumer. (1) If the agreement with respect to a consumer credit transaction contains covenants by the consumer to perform certain duties pertaining to insuring or preserving collateral, and the creditor pursuant to the agreement pays for performance of the duties on behalf of the consumer, the creditor may add the amounts paid to the debt if:

(a) The expenditure is reasonable to protect the risk of loss or damage to the property;

(b) The creditor has mailed to the consumer, at the consumer's last known address, written notice of the consumer's nonperformance and has given the consumer reasonable opportunity after such notice to so perform; and

(c) In the absence of performance, the creditor has made all expenditures on behalf of the consumer in good faith and in a commercially reasonable manner.

(2) Within a reasonable time after advancing any sums, the creditor shall state to the consumer in writing the amount of the sums advanced, any charges with respect to this amount, and any revised payment schedule, and, if the duties of the consumer performed by the creditor pertain to insurance, a brief description of the insurance paid for by the creditor including the type and amount of coverage. No further information need be given.

(3) A finance charge may be made for sums advanced pursuant to this section at a rate not exceeding the rate stated to the consumer pursuant to the provisions on disclosure contained in section 5-3-101 with respect to the consumer credit transaction; except that, with respect to a revolving account, the amount of the advance may be added to the unpaid balance of the debt and the creditor may make a finance charge not exceeding that permitted by the provisions on finance charges.

Source: L. 2000: Entire article R&RE, p. 1202, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-208, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971).

5-2-210. Right to prepay. Subject to the provisions on rebate upon prepayment contained in section 5-2-211, the consumer may prepay in full, or in part if payment is no

less than five dollars, the unpaid balance of a consumer credit transaction at any time without penalty. A payment in the amount of a scheduled installment, other than the last scheduled installment, not identified by the consumer as a partial prepayment shall not be deemed to be a partial prepayment regardless of when the payment is made if the amount equals the next scheduled installment. If such a payment is applied by the creditor to the scheduled installment, the payment shall be deemed to have been made on the due date for the scheduled installment to which it was applied.

Source: L. 2000: Entire article R&RE, p. 1202, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-209, as it existed prior to 2000.

ANNOTATION

Applied in Empire Sav., Bldg. & Loan Ass'n v. Otero Sav. & Loan Ass'n, 640 P.2d 1151 (Colo. 1982) (decided prior to 2000 repeal and reenactment).

5-2-211. Rebate upon prepayment - definitions. (1) Except as otherwise provided in this section, upon prepayment in full of the unpaid balance of a precomputed consumer credit transaction, an amount not less than the unearned portion of the finance charge calculated according to this section shall be rebated to the consumer. If the rebate otherwise required is less than one dollar, no rebate need be made.

(2) Upon prepayment in full of a consumer credit transaction, other than one pursuant to a revolving account, a refinancing, or a consolidation, whether or not precomputed, the creditor may collect or retain a minimum charge within the limits stated in this subsection (2) if the finance charge earned at the time of prepayment is less than any minimum charge contracted for. The minimum charge may not exceed the lesser of the amount of finance charge contracted for or twenty-five dollars.

(3) (a) Except as otherwise provided in this section, the unearned portion of the finance charge is a fraction of the finance charge of which the numerator is the sum of the periodic balances scheduled to follow the computational period in which prepayment occurs, and the denominator is the sum of all periodic balances under either the consumer credit agreement or, if the balance owing resulted from a refinancing described in section 5-2-205 or a consolidation described in section 5-2-206, under the refinancing agreement or consolidation agreement.

(b) With respect to a precomputed transaction entered into on or after October 28, 1975, and payable according to its original terms in more than sixty-one installments or on any precomputed transaction entered into on or after January 1, 1982, the unearned portion of the finance charge is, at the option of the lender, either:

(I) That portion that is applicable to all fully unexpired computational periods as originally scheduled, or if deferred, as deferred, that follow the date of prepayment. For this purpose, the applicable charge is the total of that which would have been made for each such period, had the consumer credit transaction not been precomputed, by applying to unpaid balances of the amount financed, according to the actuarial method, the annual percentage rate of charge previously stated to the consumer pursuant to the provisions on disclosure contained in section 5-3-101 based upon the assumption that all payments were made as originally scheduled, or if deferred, as deferred. The creditor, at the creditor's option, may round the annual percentage rate to the nearest one-half of one percent so long as such procedure is not consistently used to obtain a greater yield than would otherwise be permitted; or

(II) The total finance charge minus the earned finance charge. The earned finance charge shall be determined by applying the annual percentage rate previously stated to the consumer pursuant to the provisions on disclosure contained in section 5-3-101 according to the actuarial method to the actual unpaid balances for the actual time the balances were unpaid up to the date of prepayment. If a delinquency or deferral charge was collected, it shall be treated as a payment.

(c) In the case of a consumer credit transaction primarily secured by an interest in land, reasonable sums actually paid or payable to persons not related to the creditor for customary closing costs included in the finance charge shall be deducted from the finance charge before the calculation prescribed by this subsection (3) is made.

(4) As used in this section, unless the context otherwise requires:

(a) "Computational period" means one month if one-half or more of the intervals between scheduled payments under the agreement is one month or more and otherwise means one week.

(b) The "interval" to the due date of the first scheduled installment or the final scheduled payment date is measured from the date of a consumer credit transaction and includes either the first or last day of the interval. If the interval to the due date of the first scheduled installment does not exceed one month by more than fifteen days when the computational period is one month or eleven days when the computational period is one week, the interval shall be considered as one computational period.

(c) "Periodic balance" means the amount scheduled to be outstanding on the last day of a computational period before deducting the payment, if any, scheduled to be made on that day.

(5) (a) This subsection (5) applies only if the schedule of payments is not regular.

(b) If the computational period is one month and:

(I) If the number of days in the interval to the due date of the first scheduled installment is less than one month by more than five days or more than one month by more than five but not more than fifteen days, the unearned finance charge shall be increased by an adjustment for each day by which the interval is less than one month and, at the option of the creditor, may be reduced by an adjustment for each day by which the interval is more than one month; the adjustment for each day shall be one-thirtieth of that part of the finance charge earned in the computational period prior to the due date of the first scheduled installment assuming that period to be one month; and

(II) If the interval to the final scheduled payment date is a number of computational periods plus an additional number of days less than a full month, the additional number of days shall be considered a computational period only if sixteen days or more. This subparagraph (II) applies whether or not subparagraph (I) of this paragraph (b) applies.

(c) Notwithstanding paragraph (b) of this subsection (5), if the computational period is one month, the number of days in the interval to the due date of the first installment exceeds one month by not more than fifteen days and the schedule of payments is otherwise regular, the creditor at the creditor's option may exclude the extra days and the charge for the extra days in computing the unearned finance charge; but if the creditor does so and a rebate is required before the due date of the first scheduled installment, the creditor shall compute the earned charge for each elapsed day as one-thirtieth of the amount the earned charge would have been if the first interval had been one month.

(d) If the computational period is one week and:

(I) If the number of days in the interval to the due date of the first scheduled installment is less than five days or more than nine days but not more than eleven days, the unearned finance charge shall be increased by an adjustment for each day by which the interval is less than seven days and, at the option of the creditor, may be reduced by an adjustment for each day by which the interval is more than seven days; the adjustment for each day shall be one-seventh of that part of the finance charge earned in the computational period prior to the due date of the first scheduled installment assuming that period to be one week; and

(II) If the interval to the final scheduled payment date is a number of computational periods plus an additional number of days less than a full week, the additional number of days shall be considered a computational period only if four days or more. This subparagraph (II) applies whether or not subparagraph (I) of this paragraph (d) applies.

(6) Except as otherwise provided in paragraph (b) of subsection (3) of this section, if a deferral described in section 5-2-204 has been agreed to, the unearned portion of the finance charge is the portion thereof attributable according to the sum of the balances method to the period from the first day of the computational period following that in which prepayment occurs; except that the numerator of the fraction is the sum of the periodic balances, after rescheduling to give effect to any deferral, scheduled to follow the compu-

tational period in which prepayment occurs. A separate rebate of the deferral charge is not required unless the unpaid balance of the transaction is paid in full during the deferral period, in which event the creditor shall also rebate the unearned portion of the deferral charge.

(7) Except as otherwise provided in paragraph (b) of subsection (3) of this section, this section does not preclude the collection or retention by the creditor of delinquency charges described in section 5-2-203.

(8) If the maturity is accelerated for any reason and judgment is obtained, the consumer is entitled to the same rebate as if payment had been made on the date judgment is entered.

(9) Upon prepayment in full of a consumer credit transaction by the proceeds of consumer credit insurance described in section 5-4-103, the consumer or the consumer's estate is entitled to the same rebate as though the consumer had prepaid the agreement on the date the proceeds of the insurance are paid to the creditor but no later than ten business days after satisfactory proof of loss is furnished to the creditor.

Source: L. 2000: Entire article R&RE, p. 1203, § 1, effective July 1. **L. 2001:** IP(3)(b) and (5)(d)(I) amended, p. 28, § 3, effective March 9.

Editor's note: This section is similar to former § 5-2-210, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982).

5-2-212. Surcharges on credit transactions - prohibition. (1) Except as otherwise provided in sections 24-19.5-103 (3) and 29-11.5-103 (3), C.R.S., no seller or lessor in any sales or lease transaction or any company issuing credit or charge cards may impose a surcharge on a holder who elects to use a credit or charge card in lieu of payment by cash, check, or similar means. A surcharge is any additional amount imposed at the time of the sales or lease transaction by the merchant, seller, or lessor that increases the charge to the buyer or lessee for the privilege of using a credit or charge card. For purposes of this section, charge card includes those cards pursuant to which unpaid balances are payable on demand.

(2) A discount offered by a seller or lessor for the purpose of inducing payment by cash, check, or other means not involving the use of a seller or lender credit card shall not constitute a finance charge if such discount is offered to all prospective buyers and its availability is disclosed to all prospective buyers clearly and conspicuously in accordance with regulations of the administrator.

Source: L. 2000: Entire article R&RE, p. 1206, § 1, effective July 1. **L. 2003:** (1) amended, p. 1442, § 3, effective April 29.

Editor's note: This section is similar to former § 5-3-110, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982).

5-2-213. Lender and seller credit cards. (1) For purposes of this section, "credit card bank or financial institution" means a commercial bank, industrial bank, credit union, thrift, savings and loan association, savings bank, or other state or federally supervised institution in this state that issues credit cards and may export rates and fees pursuant to the "National Bank Act", 12 U.S.C. sec. 85, "Depository Institutions Deregulation and Monetary Control Act of 1980", 12 U.S.C. secs. 1463, 1785, and 1831d, "Federal Credit

Union Act", 12 U.S.C. sec. 1757, or "Alternative Mortgage Transaction Parity Act of 1982", 12 U.S.C. secs. 3801 to 3805, and any regulations thereunder.

(2) Notwithstanding any other provisions of this part 2, with respect to a lender or seller credit card issued by a credit card bank or financial institution:

(a) The finance charge, calculated according to the actuarial method, may not exceed the amounts provided in section 5-2-201; and

(b) Any fees imposed for a minimum finance charge described in section 5-2-201 (3) (b), annual charges described in section 5-2-202 (1) (c), cash advances described in section 5-2-202 (1) (e) (I), return or dishonor of a check described in section 5-2-202 (1) (e) (II), delinquency described in section 5-2-203, or exceeding the credit limit may be in an amount established by written agreement of the parties.

Source: L. 2000: Entire article R&RE, p. 1206, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-508, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971). For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982).

5-2-214. Alternative charges for loans not exceeding one thousand dollars. (1) For a consumer loan where the amount financed is not more than one thousand dollars, a supervised lender may charge, in lieu of the loan finance charges permitted by section 5-2-201, the following finance charges:

(a) An acquisition charge for making the original loan, not to exceed ten percent of the amount financed;

(a.5) An acquisition charge for making any refinanced loan, not to exceed seven and one-half percent of the amount financed; and

(b) A monthly installment account handling charge, not to exceed the following amounts:

Amount financed	Per month charge
$100.00 - $ 300	$12.50
$300.01 - $ 500	$15.00
$500.01 - $ 750	$17.50
$750.01 - $ 1,000	$20.00

(2) The minimum term of a loan made pursuant to this section shall be ninety days. The maximum term of a loan made pursuant to this section shall be twelve months. All loans shall be scheduled to be payable in substantially equal installments at equal periodic intervals.

(3) On a loan subject to the alternative charges authorized by this section, no other finance charge or any other charge or fee is permitted except as specifically provided for in this section and except for the delinquency charges provided for in section 5-2-203, reasonable attorney fees provided for in section 5-5-112, and the fee for a dishonored check provided for in section 5-2-202 (1) (e) (II).

(4) The acquisition charge authorized in this section shall be fully earned at the time the loan is made and shall not be subject to refund; except that, if the loan is prepaid in full, refinanced, or consolidated within the first sixty days, the first ten dollars of the acquisition charge shall be retained by the lender and the remainder of the acquisition charge shall be refunded at a rate of one-sixtieth of the remainder of the acquisition charge per day, beginning on the day after the date of the prepayment, refinancing, or consolidation and ending on the sixtieth day after the loan was made.

(5) Upon the prepayment of a loan made pursuant to this section, the unearned portion of the installment account handling charge shall be refunded to the consumer. The unearned

portion of the installment account handling charge that is refunded shall be calculated pursuant to the provisions on rebate upon prepayment contained in section 5-2-211 on the date of refinancing; except that, for the purpose of computing this amount, no minimum charge described in section 5-2-201 shall be allowed.

(6) The rates and charges permitted by this section shall not apply to deferred deposit loans subject to article 3.1 of this title.

(7) A lender shall not take collateral from a consumer as security for payment for any loan made pursuant to this section.

(8) A lender may not refinance a loan made pursuant to this section more than three times in one year.

Source: L. 2004: Entire section added, p. 589, § 1, effective August 4. **L. 2007:** (1)(a) and (5) amended and (1)(a.5), (7), and (8) added, p. 711, §§ 1, 2, effective August 3.

PART 3

SUPERVISED LOANS AND SUPERVISED LENDERS

5-2-301. Authority to make supervised loans. (1) Unless a person is a supervised financial organization or has first obtained a license from the administrator authorizing him or her to make supervised loans, he or she shall not engage in the business of:

(a) Making supervised loans or undertaking direct collection of payments from or enforcement of rights against consumers arising from supervised loans he or she has previously made; or

(b) Taking assignments of and undertaking direct collection of payments from or enforcement of rights against consumers arising from supervised loans; except that a person who is licensed by the administrator as a collection agency pursuant to article 14 of title 12, C.R.S., or is licensed by the Colorado supreme court to practice law, and who takes assignment of supervised loans only after such loans are in default, is not required to obtain a supervised lender license to engage in the activities described in this paragraph (b).

Source: L. 2000: Entire article R&RE, p. 1206, § 1, effective July 1. **L. 2006:** (1)(b) amended, p. 530, § 1, effective April 18.

Editor's note: This section is similar to former § 5-3-502, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971). For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982).

5-2-302. License to make supervised loans. (1) The administrator shall receive and act on all applications for licenses to make supervised loans under this code. Applications shall be filed in the manner prescribed by the administrator and shall contain such information as the administrator may reasonably require. No license shall be issued without payment of a nonrefundable license fee. The license year shall be the calendar year.

(2) No license shall be issued unless the administrator, upon investigation, finds that the financial responsibility, character, and fitness of the applicant and of the members, managers, partners, officers, and directors thereof are such as to warrant belief that the business will be operated honestly and fairly within the purposes of this code. In determining financial responsibility of an applicant proposing to engage in making consumer insurance premium loans, the administrator shall consider the liabilities the lender may incur for erroneous cancellation of insurance. The administrator may deny an application for licensure for any of the grounds provided in section 5-2-303.

(3) (a) Upon written request, the applicant is entitled to a hearing on the question of the applicant's qualifications for a license if:

(I) The administrator has notified the applicant in writing that his or her application has been denied; or

(II) The administrator has not issued a license within sixty days after the application for the license was filed.

(b) A request for a hearing may not be made more than sixty days after the administrator has mailed a writing to the applicant notifying the applicant that the application has been denied and stating in substance the administrator's findings supporting denial of the application.

(4) If a supervised lender has more than one place of business, it must obtain a master license. The administrator may authorize the addition of branch locations to the master license. A separate license fee and proof of financial responsibility shall be required for each authorized branch location. Each master license and branch location license shall remain in full force and effect until surrendered, suspended, or revoked.

(5) (a) The application for approval of a branch location license may be more abbreviated than the application for a new or master supervised lender's license. An application for a branch location license may be filed by any means, including facsimile or electronic filing, followed by the license fee required by this section.

(b) Upon receipt of a completed branch location license application and the required license fee, the branch location is automatically licensed for a temporary period not to exceed one hundred twenty days. If the administrator does not deny the branch location application on or before the end of that period, the temporary branch location license shall become permanent. The administrator may deny an application for a branch location for any of the grounds provided in subsection (2) of this section and section 5-2-303.

(c) The administrator's approval of an additional branch location license may be provided by letter. No license certificate need be issued for a licensed branch location. All provisions of this part 3 relating to licenses apply equally to branch location licenses.

(6) No licensee shall change the location of any place of business or license without giving the administrator at least fifteen days prior written notice. The administrator may by rule promulgated in accordance with article 4 of title 24, C.R.S., establish an administrative fee for such a change of address.

(7) A licensee shall not engage in the business of making supervised loans at any place of business for which the licensee does not hold a license, nor shall a licensee engage in business under any other name than that in the license. The administrator may by rule establish an administrative fee for such a change of name. For the purposes of this subsection (7), a consumer insurance premium loan is made at the lender's business office.

(8) Each license shall be renewed by payment of a nonrefundable license fee and the filing of a renewal form. The fee and renewal form shall be due each January 31. If a licensee fails to pay the prescribed fee on or before March 1, it shall pay a penalty of five dollars per day per license from March 2 to the date the payment is postmarked. However, if a licensee fails to pay the appropriate renewal and penalty fees by March 15, its license shall automatically expire.

(9) (Deleted by amendment, L. 2009, (HB 09-1141), ch. 41, p. 157, § 3, effective January 1, 2010.)

Source: L. 2000: Entire article R&RE, p. 1207, § 1, effective July 1. **L. 2009:** (1), (8), and (9) amended, (HB 09-1141), ch. 41, p. 157, § 3, effective January 1, 2010.

Editor's note: This section is similar to former §§ 5-3-503 and 5-6-203, as they existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971).

5-2-303. Denial and discipline of license. (1) The administrator may deny an application for a license or take disciplinary action against a person licensed to make supervised loans if the administrator finds that:

(a) The applicant or licensee has violated this code or any rule or order lawfully made pursuant thereto;

(b) Facts or conditions exist that would clearly have justified the administrator in refusing to grant a license had these facts or conditions been known to exist at the time the application for the license was made;

(c) The applicant has failed to complete an application for licensure;

(d) The applicant or licensee has failed to provide information required by the administrator within a reasonable time as fixed by the administrator;

(e) The applicant or licensee has failed to provide or maintain proof of financial responsibility;

(f) The applicant or licensee is insolvent;

(g) The applicant or licensee has made, in any document or statement filed with the administrator, a false representation of a material fact or has omitted to state a material fact;

(h) The applicant, licensee, or its owners, partners, members, officers, or directors have been convicted of or entered a plea of guilty or nolo contendere to a crime specified in part 4 of article 4 of title 18, C.R.S., or in part 1, 2, 3, 5, or 7 of article 5 of title 18, C.R.S., to a crime involving fraud or deceit, or to any similar crime under the jurisdiction of any federal court or court of another state;

(i) The applicant or licensee has failed to make, maintain, or produce records which comply with section 5-2-304 and any regulation adopted by the administrator;

(j) The applicant or licensee has been the subject of any disciplinary action by any state or federal agency;

(k) A final judgment has been entered against the applicant or licensee for violations of this code, any state or federal law concerning consumer finance, banking, or mortgage brokers or lenders, or any state or federal law prohibiting deceptive or unfair trade or business practices; or

(l) The applicant or licensee has failed to, in a timely manner as fixed by the administrator, take or provide proof of the corrective action required by the administrator subsequent to an examination or investigation pursuant to section 5-2-305 or 5-6-106.

(2) The administrator may summarily suspend a license as provided in section 24-4-104, C.R.S.

(3) Whenever the administrator denies a license application or takes disciplinary action pursuant to this section, the administrator shall enter an order to that effect and notify the licensee or applicant of the denial or disciplinary action. The notification required by this subsection (3) shall be given by personal service or by mail to the last known address of the licensee or applicant as shown on the application, license, or as subsequently furnished in writing to the administrator.

(4) Any person holding a license to make supervised loans may relinquish the license by notifying the administrator in writing of its relinquishment. The revocation, suspension, expiration, or relinquishment of a license shall not affect the licensee's liability for acts previously committed nor impair the administrator's ability to issue a final agency order or impose discipline against the licensee.

(5) No revocation, suspension, or relinquishment of a license shall impair or affect the obligation of any preexisting lawful contract between the licensee and any consumer.

(6) The administrator may reinstate a license, terminate a suspension, or grant a new license to a person whose license has been revoked or suspended if no fact or condition then exists that clearly would have justified the administrator in refusing to grant a license.

(7) After a finding of one or more of the conditions stated in subsection (1) of this section, the administrator may take any or all of the following actions:

(a) Deny an application for licensure including an application for a branch office license;

(b) Revoke the license;

(c) Suspend the license for a period of time;

(d) Issue an order to the licensee to cease and desist from such acts;

(e) Order the licensee to make refunds to consumers of excess charges under this code;

(f) Impose penalties of up to a maximum of one thousand dollars for each violation all or part of which may be specifically designated for consumer and creditor educational expenses;

(g) Bar the person from applying for or holding a license for a period of five years following revocation of his or her license;

(h) Issue a letter of admonition; or

(i) Impose a penalty of two hundred dollars per day for failure to make, produce, or retain records required to be maintained under this code within forty-eight hours after the administrator's written demand. If the administrator has provided advance written notice of forty-eight hours or more to a licensee prior to conducting an examination pursuant to section 5-2-305, the penalty may be imposed without allowing additional time.

(8) The discipline stated in paragraphs (h) and (i) of subsection (7) of this section may be imposed without a hearing, but the licensee may, within thirty days thereafter, file with the administrator a written notice requesting a hearing. If such request is timely made, the letter of admonition shall be deemed vacated and a hearing shall be held. If, after such hearing, there is a finding that one or more of the grounds for discipline exist, any or all of the forms of discipline listed in this section may be imposed.

Source: L. 2000: Entire article R&RE, p. 1209, § 1, effective July 1. **L. 2003:** (4) amended, p. 1892, § 3, effective July 1.

Editor's note: This section is similar to former §§ 5-3-503 and 5-3-504, as they existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971).

5-2-304. Records - annual reports - proof of financial responsibility. (1) Every licensee shall maintain records in conformity with this code, rules adopted thereunder, and generally accepted accounting principles and practices in a manner that will enable the administrator to determine whether the licensee is complying with the provisions of this code. The record-keeping system of a licensee shall be sufficient if the licensee makes the required information reasonably available. The records need not be kept in the place of business where supervised loans are made if the administrator is given free access to the records wherever located. The records pertaining to any loan need not be preserved for more than four years after making the final entry relating to the loan, but, in the case of a revolving loan account, the four years is measured from the date of each entry.

(2) On or before June 1 of each year, every licensee shall file with the administrator an annual report in the form prescribed by the administrator relating to all supervised loans made by the licensee, which report shall also demonstrate satisfactory proof of the licensee's financial responsibility. At all other times, the licensee shall maintain satisfactory proof of financial responsibility. The administrator shall consult with comparable officials in other states for the purpose of making the kinds of information required in annual reports uniform among the states. Information contained in annual reports shall be confidential and may be published only in composite form. The administrator may, by rule, determine the types and amounts of financial responsibility deemed to be satisfactory.

(3) If a licensee fails to file the annual report or proof of financial responsibility by July 1, the administrator may impose a penalty of five dollars per day from July 2 to the date the filing is postmarked. However, if a licensee fails to file and pay the appropriate penalty by July 15, or, at all other times, fails to provide satisfactory proof of financial responsibility within thirty days after receiving notice from the administrator, its license shall automatically expire.

Source: L. 2000: Entire article R&RE, p. 1211, § 1, effective July 1. **L. 2003:** (2) and (3) amended, p. 1893, § 4, effective July 1.

Editor's note: This section is similar to former § 5-3-505, as it existed prior to 2000.

5-2-305. Examinations and investigations. (1) The administrator shall examine periodically, at intervals the administrator deems appropriate, the loans, business, and records of every licensee. In addition, for the purpose of discovering violations of this code or securing information lawfully required, the administrator or, in lieu thereof, the official or agency to whose supervision the organization is subject pursuant to section 5-6-105, may at any time investigate the loans, business, and records of any supervised lender or any supervised financial organization. For these purposes the administrator shall have free and reasonable access to the offices, places of business, and records of the lender.

(2) (a) If the lender's records are located outside this state, the lender shall, at the lender's option, either make them available to the administrator at a convenient location within this state or pay the reasonable and necessary expenses for the administrator or the administrator's representative to examine them at the place where they are maintained; except that the lender shall make the records available for examination at the administrator's office or at any other location the administrator deems appropriate, at the cost of the lender, if the administrator determines that the examination of the records at the location where the records are maintained endangers the safety of the administrator's representative or that there are not adequate facilities at the location where the records are maintained to conduct the examination. The administrator may designate representatives, including comparable officials of the state in which the records are located, to inspect them on the administrator's behalf.

(b) The administrator may require any lender whose records are located within the state to make its records available for examination at the administrator's office or at any other location the administrator deems appropriate at the cost of the lender if the administrator determines that the examination of the records at the location where the records are maintained endangers the safety of the administrator's representative or that there are not adequate facilities at the location where the records are maintained to conduct the examination.

(3) For the purposes of this section, the administrator may administer oaths or affirmations, and, upon the administrator's own motion or upon request of any party, may subpoena witnesses, compel their attendance, adduce evidence, and require the production of any matter that is relevant to the investigation, including the existence, description, nature, custody, condition, and location of any books, documents, or other tangible things and the identity and location of persons having knowledge of relevant facts or any other matter reasonably calculated to lead to the discovery of admissible evidence.

(4) Upon failure without lawful excuse to obey a subpoena or to give testimony, the administrator may apply to the district court in the city and county of Denver for an order compelling compliance.

(5) After the administrator has examined a licensee pursuant to this section, the administrator shall provide a report of the examination to the licensee and request the licensee to take the corrective action required therein. The licensee shall, within a time and manner as fixed by the administrator, take the corrective action required in the report and provide proof that the corrective action was taken. The corrective action required may include refunds of excess charges and corrections of disclosures required by this code. This subsection (5) does not require the administrator to allow a licensee to take corrective action prior to the administrator filing legal or administrative action for repeated or willful violations of this code.

Source: L. 2000: Entire article R&RE, p. 1211, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-506, as it existed prior to 2000.

5-2-306. Administrative procedures - applicability. Except as otherwise provided, the provisions of sections 24-4-102 to 24-4-106, C.R.S., apply to and govern all rules promulgated and all administrative action taken by the administrator pursuant to this code; except that section 24-4-104 (3), C.R.S., shall not apply to any such action.

Source: L. 2000: Entire article R&RE, p. 1213, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-507, as it existed prior to 2000.

5-2-307. Judicial review. Any person aggrieved by any final action or order of the administrator and affected thereby is entitled to a review thereof by the court of appeals by appropriate proceedings under section 24-4-106 (11), C.R.S.

Source: L. 2000: Entire article R&RE, p. 1213, § 1, effective July 1.

Editor's note: This section is similar to former §§ 5-6-107 and 5-6-108, as they existed prior to 2000.

5-2-308. Regular schedule of payments - maximum loan term. (1) Supervised loans not made pursuant to a revolving credit account and in which the principal is three thousand dollars or less shall be scheduled to be payable in substantially equal installments at equal periodic intervals except to the extent that the schedule of payments is adjusted to the seasonal or irregular income of the debtor and:

(a) Over a period of not more than thirty-seven months if the principal is more than one thousand dollars; or

(b) Over a period of not more than twenty-five months if the principal is one thousand dollars or less.

Source: L. 2000: Entire article R&RE, p. 1213, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-511, as it existed prior to 2000.

5-2-309. Conduct of business other than making loans. A supervised lender may not carry on any other business for the purpose of evasion or violation of this code nor may the supervised lender extend credit on the condition or requirement that the consumer obtain additional credit, goods, or services from the supervised lender or a person related to the supervised lender unless otherwise permitted by law.

Source: L. 2000: Entire article R&RE, p. 1213, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-512, as it existed prior to 2000.

Cross references: For regulation of pawnbrokers, see article 56 of title 12.

5-2-310. Application of other provisions. Except as otherwise provided, all provisions of this code applying to consumer loans apply to supervised loans.

Source: L. 2000: Entire article R&RE, p. 1213, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-513, as it existed prior to 2000.

PART 4

(Reserved)

PART 5

OTHER CREDIT TRANSACTIONS

5-2-501. Transactions subject to code by agreement of parties. The parties to a transaction other than a consumer credit transaction may agree in a writing signed by the

parties that the transaction is subject to the provisions of this code. If the parties so agree, the transaction is a consumer credit transaction for the purposes of this code.

Source: L. 2000: Entire article R&RE, p. 1213, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-601, as it existed prior to 2000.

5-2-502. Finance charge for other transactions. With respect to a transaction that is specifically exempt from the rate ceilings of this code by the provisions of section 5-1-301 (15) (c), the parties may contract for the payment by the consumer of any finance charge up to a rate not to exceed an annual percentage rate of forty-five percent pursuant to section 18-15-104, C.R.S. The rate of the finance charge shall be calculated on the unpaid balances of the debt on the assumption that the debt will be paid according to its terms and will not be paid before the end of the agreed term.

Source: L. 2000: Entire article R&RE, p. 1214, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-605, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "The Colorado Equity Protection Act: A Response to Predatory Lending Practices", see 32 Colo. Law. 79 (April 2003).

ARTICLE 3

Regulation of Agreements and Practices

Editor's note: This article was numbered as article 3 of chapter 73, C.R.S. 1963. This title was repealed and reenacted in 1971, and this article was subsequently repealed and reenacted in 2000, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 2000, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume and the editor's note following the title heading. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated. For a detailed comparison of this article, see the comparative tables located in the back of the index.

PART 1

DISCLOSURES, NOTICES, RECORDS, AND ADVERTISING

PART 2

LIMITATIONS ON AGREEMENTS AND PRACTICES

PART 3

LIMITATION ON CONSUMERS' LIABILITIES

PART 4

HOME SOLICITATION SALES

PART 5

CONSUMER INSURANCE PREMIUM FINANCING

PART 1

DISCLOSURES, NOTICES, RECORDS, AND ADVERTISING

5-3-101. Applicability - information required. (1) For purposes of this section, a consumer credit transaction includes a transaction secured primarily by an interest in land without regard to the rate of the finance charge if the consumer credit transaction is otherwise a consumer credit transaction.

(2) The creditor shall disclose to the consumer to whom credit is extended with respect to a consumer credit transaction the information, disclosures, and notices required by the federal "Truth in Lending Act", the federal "Consumer Leasing Act", and any regulation thereunder.

(3) The information, disclosures, and notices required by subsection (2) of this section must be provided if the transaction is a consumer credit transaction under this code even though the transaction is one of a class of credit transactions exempted from the federal "Truth in Lending Act", the federal "Consumer Leasing Act", and any regulation thereunder.

Source: L. 2000: Entire article R&RE, p. 1214, § 1, effective July 1. **L. 2001:** (1) amended, p. 28, § 4, effective March 9.

Editor's note: This section is similar to former § 5-2-301, as it existed prior to 2000.

Cross references: For the definitions and federal statutory cites of the "Truth in Lending Act" and the "Consumer Leasing Act", see § 5-1-302.

5-3-102. Notice of assignment. The consumer is authorized to pay the original creditor until the consumer receives notification of assignment of rights to payment pursuant to a consumer credit transaction and that payment is to be made to the assignee. A notification that does not reasonably identify the rights assigned is ineffective. If requested by the consumer, the assignee must seasonably furnish reasonable proof that the assignment has been made and unless the assignee does so the consumer may pay the original creditor.

Source: L. 2000: Entire article R&RE, p. 1214, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-406, as it existed prior to 2000.

5-3-103. Change in terms of revolving credit accounts. (1) If a creditor makes a change in the terms of a revolving account without complying with this section, any additional cost or charge to the consumer resulting from the change is an excess charge and subject to the remedies available to consumers described in section 5-5-202 and to the administrator described in section 5-6-114.

(2) (a) Except as otherwise provided in paragraph (b) or (c) of this subsection (2), whenever any term of a revolving credit account is changed or the required minimum periodic payment thereon is increased, the creditor shall mail or deliver written notice of the change, at least one billing cycle before the effective date of the change, to each consumer who may be affected by the change.

(b) The notice required by paragraph (a) of this subsection (2) shall be given in advance, but need not be given one billing cycle in advance, if the change has been agreed to by the consumer or if the change is an increase in a finance charge, periodic rate, or other charge permitted under section 5-2-202 as a result of the consumer's delinquency or default.

(c) The notice otherwise required by paragraph (a) of this subsection (2) is not required if the change:

(I) Results from the consumer's delinquency or default but is not of a kind listed in paragraph (b) of this subsection (2);

(II) Results from an agreement related to a court proceeding or arbitration;

(III) Is a reduction of any charge or component thereof; or

(IV) Is a suspension of future credit privileges or termination of a consumer credit transaction.

(3) The notice provisions of subsection (2) of this section shall not apply if:

(a) The consumer, after receiving notice in writing of the specific change, agrees in writing to the change;

(b) The consumer elects to pay an amount designated on a billing statement as including a new charge for a benefit offered to the consumer when the benefit and charge constitutes the change in terms and when the billing statement also states the amount payable if the new charge is excluded;

(c) The change involves no significant cost to the consumer; or

(d) The agreement provides limitations on changing of terms that are more restrictive than the requirements of subsection (2) of this section.

(4) The notice provided for in this section is given to the consumer when mailed to the consumer at the address used by the creditor for sending periodic billing statements.

Source: L. 2000: Entire article R&RE, p. 1214, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-416, as it existed prior to 2000.

5-3-104. Receipts - statements of account - evidence of payment. (1) The creditor shall deliver or mail to the consumer, without request, a written receipt for each payment by coin or currency on an obligation pursuant to a consumer credit transaction. A periodic statement showing a payment received by the creditor complies with this subsection (1).

(2) Upon written request of a consumer, the creditor of a consumer credit transaction, other than one pursuant to a revolving credit account, shall provide a written statement of the dates and amounts of payments made within the twelve months preceding the month in which the request is received and the total amount unpaid as of the end of the period covered by the statement. The statement shall be provided without charge twice during each year of the term of the obligation. If additional statements are requested, the creditor may charge not more than ten dollars for each additional statement.

(3) Within thirty days after a consumer has fulfilled all obligations with respect to a consumer credit transaction, other than one pursuant to a revolving credit account, the creditor shall deliver or mail to the consumer written evidence acknowledging payment in full of all obligations with respect to the transaction and written evidence of release of any security interest and termination of any financing statement held, retained, or acquired.

Source: L. 2000: Entire R&RE, p. 1216, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-110, as it existed prior to 2000.

5-3-105. Notice to cosigners and similar parties. (1) No natural person, other than the spouse of the consumer, shall be obligated as a cosigner, comaker, guarantor, endorser, surety, or similar party with respect to a consumer credit transaction, unless before or contemporaneously with signing any agreement of obligation or any writing setting forth the terms of the consumer's agreement, the person receives a written notice that contains a completed identification of the debt he or she may have to pay and reasonably informs such person of his or her obligation with respect to it. Such written notice may be set forth in the consumer's agreement of obligation or in a separate writing. For purposes of this section, the word "cosigner", "comaker", "guarantor", "endorser", or "surety" means a natural person who, by agreement and without compensation, renders himself or herself liable for the obligation of another in a consumer credit transaction, and the terms "agreement" and "consumer's agreement" mean the original underlying agreement.

(2) The notice required by this section must be clear and conspicuous notice and comply with the disclosure requirements of 16 CFR 444.3, 12 CFR 227.14, or 12 CFR 535.3.

(3) The notice required by this section need not be given to a seller, lessor, or lender who is obligated to an assignee of his or her rights.

(4) A person entitled to notice pursuant to this section shall also be given a copy of any writing setting forth the terms of the consumer's agreement and of any separate agreement of obligation signed by the person entitled to the notice.

(5) A cosignor is entitled to a notice of right to cure pursuant to sections 5-5-110 (4) and 5-5-111 (3).

Source: L. 2000: Entire article R&RE, p. 1216, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 5-5-109, as it existed prior to 2000.

(2) Although this section was effective July 1, 2000, section 5 of chapter 265, Session Laws of Colorado 2000, provides that the disclosures described in subsection (5) are effective January 1, 2001.

5-3-106. Disclosures for real estate secured consumer credit transactions. (1) With respect to a real estate secured consumer credit transaction payable in installments, other than one pursuant to a revolving credit account, if the creditor credits payments made after the due date as of the date of receipt rather than the date payment was due, the creditor must clearly and conspicuously disclose to the consumer at or before the time that credit is extended the effect of untimely payments using language in substantially the following form:

"The dollar amount of the finance charge disclosed to you for this credit transaction is based upon your payments being received by the creditor on the date payments are due. If your payments are received after the due date, even if received before the date a late fee applies, you may owe additional and substantial money at the end of the credit transaction and there may be little or no reduction of principal. This is due to the accrual of daily interest until a payment is received."

(2) A creditor that makes or arranges for extensions of consumer loans secured by a dwelling and that uses credit scores for that purpose shall, upon request of the consumer, provide to the consumer to whom the credit report relates, as soon as practicable and reasonable, but in a period not to exceed thirty days, a copy of the information specifically required to be disclosed pursuant to section 12-14.3-104.3 (1), C.R.S., in such form as obtained from a consumer reporting agency as defined in section 12-14.3-102 (4), C.R.S. The creditor may charge a reasonable fee for making such information available to the consumer and such charge shall be an additional charge within the meaning of section 5-2-202 and not part of the finance charge.

(3) (a) Nothing in subsection (2) of this section shall require the creditor to:

(I) Explain to the consumer the information specifically required to be disclosed pursuant to section 12-14.3-104.3 (1), C.R.S.;

(II) Disclose any information other than the information required pursuant to subsection (2) of this section;

(III) Disclose any credit score or related information obtained by the creditor after the transaction occurs; or

(IV) Provide more than one disclosure to any one consumer per credit transaction.

(b) The creditor's obligation pursuant to subsection (2) of this section and this subsection (3) shall be limited to providing a copy of the information that was received from a consumer reporting agency, as defined in section 12-14.3-102 (4), C.R.S. A creditor who uses a credit score has no liability under this subsection (3) or subsection (2) of this section for the content of the credit score information received from a consumer reporting agency or from the omission of any information within the report provided by the consumer reporting agency.

Source: L. 2000: Entire article R&RE, p. 1217, § 1, effective July 1. **L. 2001:** Entire section amended, p. 28, § 5, effective March 9. **L. 2002:** Entire section amended, p. 647, § 3, effective July 1, 2003. **L. 2003:** (1) amended, p. 1893, § 5, effective July 1.

Editor's note: Although this section was effective July 1, 2000, section 5 of chapter 265, Session Laws of Colorado 2000, provides that the disclosures described in this section are effective January 1, 2001.

5-3-107. Disclosures for consumer credit sale secured by a motor vehicle. If the property that secures a consumer credit sale includes a motor vehicle and the written agreement does not provide for automobile liability insurance, the following clause shall be in the written agreement in capital letters and bold-face type: **"THIS CONTRACT DOES NOT PROVIDE FOR AUTOMOBILE LIABILITY INSURANCE, AND SAID BUYER ALSO STATES THAT HE OR SHE HAS/DOES NOT HAVE** (strike words not applicable) **IN EFFECT AN AUTOMOBILE LIABILITY POLICY AS DEFINED IN SECTION 42-7-103 (2), COLORADO REVISED STATUTES, ON THE MOTOR VEHICLE SOLD BY THIS CONTRACT."**

Source: L. 2000: Entire article R&RE, p. 1217, § 1, effective July 1. **L. 2009:** Entire section amended, (SB 09-292), ch. 369, p. 1939, § 4, effective August 5.

5-3-108. Written agreement required. No consumer credit transaction shall be valid or enforceable in this state unless its terms are contained in a written agreement and a copy is provided to the consumer at or before the time credit is extended. A creditor may provide the copy to the consumer in a form other than paper upon the consumer's written authorization.

Source: L. 2000: Entire article R&RE, p. 1217, § 1, effective July 1.

ANNOTATION

Law reviews. For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982). For article, "Colorado Usury: The Sequel - Parts I and 2", see 23 Colo. Law. 565 and 829 (1994).

Applied in D.E.B. Adjustment Co. v. Cawthorne, 623 P.2d 82 (Colo. App. 1981) (decided prior to 2000 repeal and reenactment).

5-3-109. Records. Every creditor shall maintain records in conformity with this code, rules adopted thereunder, and generally accepted accounting principles and practices in a manner that will establish that the creditor is complying with the provisions of this code. The record-keeping system of a creditor shall be sufficient if the creditor makes the required

information reasonably available. The records pertaining to any credit transaction need not be preserved for more than four years after making the final entry relating to the transaction, but, in the case of a revolving credit account, the four years is measured from the date of each entry.

Source: L. 2000: Entire article R&RE, p. 1217, § 1, effective July 1.

5-3-110. Advertising. (1) A creditor may not advertise, print, display, publish, distribute, broadcast, transmit or cause to be advertised, printed, displayed, published, distributed, broadcast, or transmitted in any manner any false, misleading, or deceptive statement or representation with regard to the rates, terms, or conditions of credit of a consumer credit transaction.

(2) This section imposes no liability on the owner or personnel, as such, of any medium in which an advertisement appears or through which it is disseminated.

(3) Advertising that complies with the federal "Truth in Lending Act" and the federal "Consumer Leasing Act" does not violate this section.

Source: L. 2000: Entire article R&RE, p. 1217, § 1, effective July 1.

Editor's note: This section is similar to former §§ 5-2-312 and 5-2-313, as they existed prior to 2000.

Cross references: For the definitions and federal statutory cites of the "Truth in Lending Act" and the "Consumer Leasing Act", see § 5-1-302.

5-3-111. Use of credit scores. Any provision in a contract that prohibits the disclosure of a credit score by a consumer reporting agency or a person who makes or arranges loans secured by a dwelling is void. For the purposes of this section, "dwelling" means a residential structure that contains one to four units, whether or not that structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, or trailer, if it is used as a residence.

Source: L. 2002: Entire section added, p. 648, § 4, effective July 1, 2003.

PART 2

LIMITATIONS ON AGREEMENTS AND PRACTICES

5-3-201. Security in sales or leases. (1) With respect to a consumer credit sale, a creditor may take a security interest in the property sold. In addition, a creditor may take a security interest in goods upon which services are performed or to which goods sold are annexed, or in land to which the goods are affixed or that is maintained, repaired, or improved as a result of the sale of the goods or services, if in the case of a security interest in land the debt secured is three thousand dollars or more, or in the case of a security interest in goods the debt secured is one thousand dollars or more. Except as provided with respect to cross-collateral described in section 5-3-202, a creditor may not otherwise take a security interest in property of the consumer to secure the debt arising from a consumer credit sale.

(2) With respect to a consumer lease, a creditor may not take a security interest in property of the consumer to secure the debt arising from the lease. This subsection (2) does not apply to a security deposit for a consumer lease.

(3) A security interest taken in violation of this section is void.

Source: L. 2000: Entire article R&RE, p. 1218, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-407, as it existed prior to 2000.

5-3-202. Cross-collateral. (1) In addition to contracting for a security interest pursuant to the provisions on security in sales or leases contained in section 5-3-201, a seller in a consumer credit sale may secure the debt arising from the sale by contracting for a security interest in other property if as a result of a prior sale the seller has an existing security interest in the other property. The seller may also contract for a security interest in the property sold in the subsequent sale as security for the previous debt.

(2) If the seller contracts for a security interest in other property pursuant to this section, the rate of finance charge thereafter on the aggregate unpaid balances so secured may not exceed that permitted if the balances so secured were consolidated pursuant to the provisions on consolidation involving a refinancing contained in section 5-2-205 (1). The seller has a reasonable time after so contracting to make any adjustments required by this section. "Seller" in this section does not include an assignee not related to the original seller.

Source: L. 2000: Entire article R&RE, p. 1218, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-408, as it existed prior to 2000.

5-3-203. Debt secured by cross-collateral. (1) If debts arising from two or more consumer credit sales, other than sales pursuant to a revolving credit account, are secured by cross-collateral or consolidated into one debt payable on a single schedule of payments and the debt is secured by security interests taken with respect to one or more of the sales, payments received by the seller after the taking of the cross-collateral or the consolidation are deemed, for the purpose of determining the amount of the debt secured by the various security interests, to have been applied first to the payment of the debts arising from the sales first made. To the extent debts are paid according to this section, security interests in items of property terminate as the debts originally incurred with respect to each item are paid.

(2) Payments received by the seller upon a revolving credit account are deemed, for the purpose of determining the amount of the debt secured by the various security interests, to have been applied first to the payment of finance charges in the order of their entry to the account and then to the payment of debts in the order in which the entries to the account showing the debts were made.

(3) If the debts consolidated arose from two or more sales made on the same day, payments received by the seller are deemed, for the purpose of determining the amount of the debt secured by the various security interests, to have been applied first to the payment of the smallest debt.

Source: L. 2000: Entire article R&RE, p. 1219, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-409, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971).

5-3-204. Restrictions on interest in land as security. (1) With respect to a consumer loan in which the amount financed is three thousand dollars or less, a lender may not contract for an interest in land as security. A security interest taken in violation of this section is void.

(2) For the purposes of this section, on revolving credit accounts, the amount financed shall be determined by the limit in the amount of credit made available to or for the account of the consumer if that limit is established by an express written agreement by the lender and if the lender does not retain the right to unilaterally reduce that credit limit, except in the event of default.

Source: L. 2000: Entire article R&RE, p. 1219, § 1, effective July 1.

Editor's note: This section is similar to former § 5-3-510, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "An Overview of Home Equity as Security for a Line of Credit", see 14 Colo. Law. 226 (1985).

5-3-205. Use of multiple agreements. A creditor may not use multiple agreements with respect to a single consumer credit transaction for the purpose of obtaining a higher finance charge than would otherwise be permitted by this code or to avoid disclosure of an annual percentage rate pursuant to the provisions on disclosure and advertising. Dividing a single consumer credit transaction between a husband and wife shall be presumed to be a violation of this section. The excess amount of finance charge provided for in agreements in violation of this section is an excess charge for the purposes of the provisions on the effect of violations on rights of parties contained in section 5-5-201 and the provisions on civil actions by the administrator contained in section 5-6-114.

Source: L. 2000: Entire article R&RE, p. 1219, § 1, effective July 1.

Editor's note: This section is similar to former §§ 5-2-402 and 5-3-409, as they existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971).

5-3-206. No assignment of earnings. (1) A creditor may not take an assignment of earnings of the consumer for payment or as security for payment of a debt arising out of a consumer credit transaction. An assignment of earnings in violation of this section is unenforceable by the assignee of the earnings and revocable by the consumer.

(2) A sale of unpaid earnings made in consideration of the payment of money to or for the account of the seller of the earnings is deemed to be a loan to him or her secured by an assignment of earnings.

Source: L. 2000: Entire article R&RE, p. 1220, § 1, effective July 1.

Editor's note: This section is similar to former §§ 5-2-410 and 5-3-403, as they existed prior to 2000.

5-3-207. Authorization to confess judgment prohibited. A consumer may not authorize any person to confess judgment on a claim arising out of a consumer credit transaction. An authorization in violation of this section is void.

Source: L. 2000: Entire article R&RE, p. 1220, § 1, effective July 1.

Editor's note: This section is similar to former §§ 5-2-415 and 5-3-407, as they existed prior to 2000.

5-3-208. Balloon payments. With respect to a consumer credit transaction other than one pursuant to a revolving credit account, if any scheduled payment is more than twice as large as the average of all other regularly scheduled payments, the consumer has the right to refinance the amount of that payment at the time it is due at the creditor's prevailing rates

for such type of transaction if the consumer meets the creditor's normal credit standards and if the creditor is, at that time, in the business of making such transactions. The creditor shall disclose this right in writing to the consumer at the time the transaction is entered into. These provisions do not apply to the extent that the payment schedule is adjusted to the seasonal or irregular income of the consumer. This section shall not apply to a transaction of a class defined by rule of the administrator promulgated in accordance with article 4 of title 24, C.R.S., as not requiring for the protection of the consumer his or her right to refinance as provided in this section.

Source: L. 2000: Entire article R&RE, p. 1220, § 1, effective July 1.

Editor's note: This section is similar to former §§ 5-2-405 and 5-3-402, as they existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971).

5-3-209. Referral sales. With respect to a consumer credit sale or consumer lease, the seller or lessor may not give or offer to give a rebate or discount or otherwise pay or offer to pay value to the consumer as an inducement for a sale or lease in consideration of the consumer giving to the seller or lessor the names of prospective purchasers or lessees, or otherwise aiding the seller or lessor in making a sale or lease to another person, if the earning of the rebate, discount, or other value is contingent upon the occurrence of an event subsequent to the time the consumer agrees to buy or lease. If a consumer is induced by a violation of this section to enter into a consumer credit sale or consumer lease, the agreement is unenforceable by the seller or lessor and the consumer, at his or her option, may rescind the agreement or retain the goods delivered and the benefit of any services performed without any obligation to pay for them.

Source: L. 2000: Entire article R&RE, p. 1220, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-411, as it existed prior to 2000.

5-3-210. Discrimination prohibited. No consumer credit transaction regulated by this code shall be denied any person, nor shall terms and conditions be made more stringent, on the basis of discrimination, solely because of disability, race, creed, religion, color, sex, sexual orientation, marital status, national origin, or ancestry. This section shall not apply to any consumer credit transaction made or denied by a seller, lessor, or lender whose total original unpaid balances arising from consumer credit transactions for the previous calendar year are less than one million dollars.

Source: L. 2000: Entire article R&RE, p. 1220, § 1, effective July 1. **L. 2008:** Entire section amended, p. 1598, § 10, effective May 29.

Editor's note: This section is similar to former § 5-1-109, as it existed prior to 2000.

Cross references: (1) For civil liability for discrimination, see § 5-5-206; for discrimination generally, see article 34 of title 24.

(2) For the legislative declaration contained in the 2008 act amending this section, see section 1 of chapter 341, Session Laws of Colorado 2008.

PART 3

LIMITATIONS ON CONSUMERS' LIABILITIES

5-3-301. Restriction on liability in consumer lease. The obligation of a lessee upon expiration of a consumer lease, may not exceed twice the average payment allocable to a

monthly period under the lease. This limitation does not apply to charges for damages to the leased property or for other default.

Source: L. 2000: Entire article R&RE, p. 1221, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-406, as it existed prior to 2000.

5-3-302. Limitation on default charges. Except for reasonable expenses incurred in realizing on a security interest, the agreement with respect to a consumer credit transaction may not provide for charges as a result of default by the consumer other than those authorized by this code. A provision in violation of this section is unenforceable.

Source: L. 2000: Entire article R&RE, p. 1221, § 1, effective July 1.

Editor's note: This section is similar to former §§ 5-2-414 and 5-3-405, as they existed prior to 2000.

ANNOTATION

Because this section provides that only those charges allowable elsewhere under the UCCC plus reasonable expenses in realizing a security interest are permissible as default charges, higher default interest on a note is unenforceable. First Nat. Bank v. Union Tavern Corp., 794 P.2d 261 (Colo. App. 1990) (decided prior to 2000 repeal and reenactment).

5-3-303. Assignee subject to claims and defenses. (1) With respect to a consumer credit sale or consumer lease, an assignee of the rights of the seller or lessor is subject to all claims and defenses of the buyer against the seller or lessor arising from the sale or lease of goods or services, notwithstanding that the assignee is a holder in due course of a negotiable instrument issued in connection with the consumer credit sale or consumer lease.

(2) A claim or defense of a consumer specified in subsection (1) of this section may be asserted against the assignee under this section only to the extent of the amount owing to the assignee with respect to the sale or lease of the goods or services as to which the claim or defense arose at the time the assignee has written notice of the claim or defense.

(3) For the purpose of determining the amount owing to the assignee with respect to the sale or lease:

(a) Payments received by the assignee after the consolidation of two or more consumer credit sales, except pursuant to a revolving credit account, are deemed to have been first applied to the payment of the sales first made; if the sales consolidated arose from sales made on the same day, payments are deemed to have been first applied to the smallest sale; and

(b) Payments received upon a revolving credit account are deemed to have been first applied to the payment of finance charges in the order of their entry to the account and then to the payment of debts in the order in which the entries of the debts are made to the account.

(4) An agreement may not limit or waive the claims or defenses of a consumer under this section.

Source: L. 2000: Entire article R&RE, p. 1221, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-403, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971).

5-3-304. Use of account - constructive assent to terms. The use of a revolving credit account by a consumer, or by any person authorized by the consumer, constitutes the consumer's acceptance of the creditor's offer of credit and creates a binding contract on the creditor's terms then in effect. Such terms may be modified in the future as agreed by the parties and subject to the requirements of this article, including, but not limited to, the notice requirements of section 5-3-103.

Source: L. 2000: Entire article R&RE, p. 1222, § 1, effective July 1.

Editor's note: This section is similar to former §§ 5-2-417 and 5-3-411, as they existed prior to 2000.

5-3-305. Advance payment to reserve lodging and motor vehicle rental services - notice to consumer required. If a deposit, reservation fee, or other advance payment is to be charged to a revolving credit account for lodging or motor vehicle rental services to be provided in the future in this state, the seller shall not charge such advance payment to the consumer's account without first notifying the consumer, either orally or in writing, and giving the consumer the opportunity to reject the services.

Source: L. 2000: Entire article R&RE, p. 1222, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-418, as it existed prior to 2000.

PART 4

HOME SOLICITATION SALES

5-3-401. Definitions - "home solicitation sale". "Home solicitation sale" means a consumer credit sale of goods or services in which the seller or a person acting for the seller personally solicits the sale and the buyer's agreement or offer to purchase is given to the seller or a person acting for the seller at a residence. It does not include a sale made pursuant to a preexisting revolving credit account, a sale made pursuant to prior negotiations between the parties at a business establishment at a fixed location where goods or services are offered or exhibited for sale, a transaction conducted and consummated entirely by mail or telephone, or a sale that is subject to the provisions of the federal "Truth in Lending Act" on the consumer's right to rescind certain transactions.

Source: L. 2000: Entire article R&RE, p. 1222, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-501, as it existed prior to 2000.

Cross references: For the definition and federal statutory cite of the "Truth in Lending Act", see § 5-1-302.

5-3-402. Buyer's right to cancel. (1) Except as provided in subsection (5) of this section, in addition to any right otherwise to revoke an offer, the buyer has the right to cancel a home solicitation sale until midnight of the third business day after the day on which the buyer signs an agreement or offer to purchase that complies with this part 4.

(2) Cancellation occurs when the buyer gives written notice of cancellation to the seller at the address stated in the agreement or offer to purchase.

(3) Notice of cancellation, if given by mail, is given when it is deposited in a mail box properly addressed and postage prepaid.

(4) Notice of cancellation given by the buyer need not take a particular form and is sufficient if it indicates by any form of written expression the intention of the buyer not to be bound by the home solicitation sale.

(5) The buyer may not cancel a home solicitation sale if, by separate dated and signed statement that is not as to its material provisions a printed form and describes an emergency

requiring immediate remedy, the buyer requests the seller to provide goods or services without delay in order to safeguard the health, safety, or welfare of natural persons or to prevent damage to property the buyer owns or for which the buyer is responsible, and:

(a) The seller in good faith makes a substantial beginning of performance of the contract before the buyer gives notice of cancellation; and

(b) In the case of goods, the goods cannot be returned to the seller in substantially as good condition as when received by the buyer.

Source: L. 2000: Entire article R&RE, p. 1222, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-502, as it existed prior to 2000.

5-3-403. Form of agreement or offer - statement of buyer's rights. (1) In a home solicitation sale, unless the buyer requests the seller to provide goods or services without delay in an emergency, the seller must present to the buyer, and obtain his signature to, a written agreement or offer to purchase that designates as the date of the transaction the date on which the buyer actually signs and contains a statement of the buyer's rights that complies with subsection (2) of this section. A copy of any writing required by this subsection (1) to be signed by the buyer, completed at least as to the date of the transaction and the name and mailing address of the seller, shall be given to the buyer at the time the buyer signs the writing.

(2) The statement shall comply with any notice of cancellation or a similar requirement of any trade regulation rule of the federal trade commission that by its terms applies to the home solicitation sale.

(3) Until the seller has complied with this section, the buyer may cancel the home solicitation sale by notifying the seller in any manner and by any means of the buyer's intention to cancel; except that the buyer's right of cancellation shall expire three years after the date of the consummation of the home solicitation sale, notwithstanding the fact that the seller has not complied with this part 4.

Source: L. 2000: Entire article R&RE, p. 1223, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-503, as it existed prior to 2000.

5-3-404. Restoration of down payment. (1) Within ten days after a notice of cancellation has been received by the seller or an offer to purchase has been otherwise revoked, the seller shall tender to the buyer any payments made by the buyer, any note or other evidence of indebtedness, and any goods traded in. A provision permitting the seller to keep all or any part of any goods traded in, payment, note, or other evidence of indebtedness is in violation of this section and unenforceable.

(2) If the down payment includes goods traded in, the goods shall be tendered in substantially as good condition as when received by the seller. If the seller fails to tender the goods as provided by this section, the buyer may elect to recover an amount equal to the trade-in allowance stated in the agreement.

(3) Until the seller has complied with the obligations imposed by this section, the buyer may retain possession of goods delivered to the buyer by the seller and has a lien on the goods in the buyer's possession or control for any recovery to which the buyer is entitled.

Source: L. 2000: Entire article R&RE, p. 1223, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-504, as it existed prior to 2000.

5-3-405. Duty of buyer - no compensation for services prior to cancellation. (1) Except as provided by the provisions on retention of goods by the buyer contained in section 5-3-404 (3) and allowing for ordinary wear and tear or consumption of the goods contemplated by the transaction, within a reasonable time after a home solicitation sale has

been canceled or an offer to purchase revoked, the buyer upon demand must tender to the seller any goods delivered by the seller pursuant to the sale, but the buyer is not obligated to tender at any place other than the buyer's residence. If the seller fails to demand possession of goods within a reasonable time after cancellation or revocation, the goods become the property of the buyer without obligation to pay for them. For the purpose of this section, forty days is presumed to be a reasonable time.

(2) The buyer has a duty to take reasonable care of the goods in his or her possession before cancellation or revocation and for a reasonable time thereafter during which time the goods are otherwise at the seller's risk.

(3) If a home solicitation sale is canceled, the seller is not entitled to compensation for any services the seller performed pursuant to it.

Source: L. 2000: Entire article R&RE, p. 1224, § 1, effective July 1.

Editor's note: This section is similar to former § 5-2-505, as it existed prior to 2000.

PART 5

CONSUMER INSURANCE PREMIUM FINANCING

5-3-501. Scope. The provisions of this part 5 apply to consumer insurance premium loans.

Source: L. 2000: Entire article R&RE, p. 1224, § 1, effective July 1.

Editor's note: This section is similar to former § 5-7-101, as it existed prior to 2000.

5-3-502. Form of insurance premium loan agreement. An agreement pursuant to which a consumer insurance premium loan is made shall contain the names of the insurance agent or broker negotiating each policy or contract and of the insurer issuing each policy or contract, the number and inception date of and premium for each policy or contract, the date on which the term of the loan begins, and a clear and conspicuous notice that each policy or contract may be canceled if payment is not made in accordance with the agreement. If a policy or contract has not been issued by the time the agreement is signed, the agreement may provide that the insurance agent or broker may insert the appropriate information in the agreement and, if he or she does so, shall furnish the information promptly in writing to the insured.

Source: L. 2000: Entire article R&RE, p. 1224, § 1, effective July 1.

Editor's note: This section is similar to former § 5-7-102, as it existed prior to 2000.

5-3-503. Notice of cancellation. If a default exists on a consumer insurance premium loan and any right to cure that exists has expired without cure being effected, the lender may give notice of cancellation of each insurance policy or contract to be canceled. If given, the notice of cancellation shall be in writing and given to the insurer who issued the policy or contract and to the insured. The insurer, within two business days after receipt of the notice of cancellation together with a copy of the insurance premium loan agreement if not previously given to the insurer, shall give any notice of cancellation required by the policy, contract, or law and, within ten business days after the effective date of the cancellation, pay to the lender any premium unearned on the policy or contract as of that effective date. Within ten business days after receipt of the unearned premium, the lender shall pay to the consumer indebted upon the insurance premium loan any excess of the unearned premium received over the amount owing by the consumer upon the insurance premium loan.

Source: L. 2000: Entire article R&RE, p. 1224, § 1, effective July 1.

Editor's note: This section is similar to former § 5-7-103, as it existed prior to 2000.

ARTICLE 3.1

Deferred Deposit Loan Act

Law reviews: For article, "Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act", see 83 Den. U.L. Rev. 387 (2005).

5-3.1-101. Short title. This article shall be known and may be cited as the "Deferred Deposit Loan Act".

Source: L. 2000: Entire article added, p. 439, § 1, effective July 1.

5-3.1-102. Definitions. As used in this article, unless the context otherwise requires:

(1) "Administrator" means the administrator of the "Uniform Consumer Credit Code".

(1.5) "Annual percentage rate" means an annual percentage rate as determined pursuant to section 107 of the federal "Truth in Lending Act", 15 U.S.C. sec. 1601 et seq. All finance charges shall be included in the calculation of the annual percentage rate.

(2) "Consumer" means a person other than an organization who is the buyer, lessee, or debtor to whom credit is granted in a consumer credit transaction.

(2.5) "Default" means a consumer's failure to repay a deferred deposit loan in compliance with the terms contained in a deferred deposit loan agreement.

(3) "Deferred deposit loan" or "payday loan" means a consumer loan whereby the lender, for a fee, finance charge, or other consideration, does the following:

(a) Accepts a dated instrument from the consumer as sole security for the loan and no other collateral;

(b) Agrees to hold the instrument for a period of time prior to negotiation or deposit of the instrument; and

(c) Pays to the consumer, credits to the consumer's account, or pays to another person on the consumer's behalf the amount of the instrument, less finance charges permitted by section 5-3.1-105.

(4) "Instrument" means a personal check or authorization to transfer or withdraw funds from an account signed by the consumer and made payable to a person subject to this article.

(5) (a) "Lender" means any person who offers or makes a deferred deposit loan, who arranges a deferred deposit loan for a third party, or who acts as an agent for a third party, regardless of whether the third party is exempt from licensing under this article or whether approval, acceptance, or ratification by the third party is necessary to create a legal

obligation for the third party, through any method including mail, telephone, internet, or any electronic means.

(b) Lender includes, but is not limited to, a supervised financial organization as defined in section 5-1-301 (45).

(c) Notwithstanding that a bank, saving and loan association, credit union, or supervised lender may be exempted by federal law from this code's interest rate, finance charges, and licensure provisions, all other applicable provisions of this code apply to both a deferred deposit loan and a deferred deposit lender.

(6) "Loan amount" means the amount financed as defined in regulation z of the federal "Truth in Lending Act", 12 CFR 226.18 (b), as amended, or as supplemented by this code, articles 1 to 9 of this title.

Source: L. 2000: Entire article added, p. 439, § 1, effective July 1. **L. 2001:** (5)(b) amended, p. 29, § 6, effective March 9. **L. 2004:** (2.5) added and (3) (a) amended, p. 317, § 1, effective July 1. **L. 2010:** (1.5) added and IP(3) and (5)(a) amended, (HB 10-1351), ch. 267, p. 1221, § 2, effective August 11.

Cross references: For the legislative declaration in the 2010 act adding subsection (1.5) and amending the introductory portion to subsection (3) and subsection (5)(a), see section 1 of chapter 267, Session Laws of Colorado 2010.

5-3.1-103. Written agreement requirements. Each deferred deposit loan transaction and renewal shall be documented by a written agreement signed by both the lender and consumer. The written agreement shall contain the name of the consumer; the transaction date; the amount of the instrument; the annual percentage rate charged; a statement of the total amount of finance charges charged, expressed both as a dollar amount and an annual percentage rate; and the name, address, and telephone number of any agent or arranger involved in the transaction. In addition, the written agreement shall include all disclosures required by section 5-3-101 (2). The written agreement shall set a date upon which the instrument may be deposited or negotiated. There shall be no maximum loan term or minimum finance charge. The minimum loan term shall be six months from the loan transaction date. The lender shall accept prepayment from a consumer prior to the loan due date and shall not charge the consumer a penalty if the consumer opts to prepay the loan. A lender may hold an instrument and delay completion of the transaction beyond the loan due date without any additional written agreement or new disclosure, but the lender may not charge any additional fees for holding the instrument or delaying the completion of the transaction.

Source: L. 2000: Entire article added, p. 440, § 1, effective July 1. **L. 2001:** Entire section amended, p. 29, § 7, effective March 9. **L. 2003:** Entire section amended, p. 1893, § 6, effective July 1. **L. 2004:** Entire section amended, p. 317, § 2, effective July 1. **L. 2010:** Entire section amended, (HB 10-1351), ch. 267, p. 1222, § 3, effective August 11.

Cross references: For the legislative declaration in the 2010 act amending this section, see section 1 of chapter 267, Session Laws of Colorado 2010.

5-3.1-104. Notice to consumers. A lender shall provide the following notice in a prominent place on each loan agreement in at least ten-point type:

A DEFERRED DEPOSIT LOAN IS NOT INTENDED TO MEET LONG-TERM FINANCIAL NEEDS.

A DEFERRED DEPOSIT LOAN SHOULD BE USED ONLY TO MEET SHORT-TERM CASH NEEDS.

RENEWING THE DEFERRED DEPOSIT LOAN RATHER THAN PAYING THE DEBT IN FULL WILL REQUIRE ADDITIONAL FINANCE CHARGES.

Source: L. 2000: Entire article added, p. 440, § 1, effective July 1.

5-3.1-105. Authorized interest rate. A lender may charge a finance charge for each deferred deposit loan or payday loan that may not exceed twenty percent of the first three hundred dollars loaned plus seven and one-half percent of any amount loaned in excess of three hundred dollars. Such charge shall be deemed fully earned as of the date of the transaction. The lender may also charge an interest rate of forty-five percent per annum for each deferred deposit loan or payday loan. If the loan is prepaid prior to the maturity of the loan term, the lender shall refund to the consumer a prorated portion of the annual percentage rate based upon the ratio of time left before maturity to the loan term. In addition, the lender may charge a monthly maintenance fee for each outstanding deferred deposit loan, not to exceed seven dollars and fifty cents per one hundred dollars loaned, up to thirty dollars per month. The monthly maintenance fee may be charged for each month the loan is outstanding thirty days after the date of the original loan transaction. The lender shall charge only those charges authorized in this article in connection with a deferred deposit loan.

Source: L. 2000: Entire article added, p. 441, § 1, effective July 1. **L. 2010:** Entire section amended, (HB 10-1351), ch. 267, p. 1222, § 4, effective August 11.

Cross references: For the legislative declaration in the 2010 act amending this section, see section 1 of chapter 267, Session Laws of Colorado 2010.

5-3.1-106. Maximum loan amount - right to rescind. (1) A lender shall not lend an amount greater than five hundred dollars nor shall the amount financed exceed five hundred dollars by any one lender at any time to a consumer. Nothing in this subsection (1) shall preclude a lender from making more than one loan to a consumer so long as the total amount financed does not exceed five hundred dollars at any one time and there is at least a thirty-day waiting period between loans.

(2) A consumer shall have the right to rescind the deferred deposit loan on or before 5 p.m. the next business day following the loan transaction.

Source: L. 2000: Entire article added, p. 441, § 1, effective July 1. **L. 2004:** (1) amended, p. 318, § 3, effective July 1. **L. 2010:** (1) amended, (HB 10-1351), ch. 267, p. 1223, § 5, effective August 11.

Cross references: For the legislative declaration in the 2010 act amending subsection (1), see section 1 of chapter 267, Session Laws of Colorado 2010.

5-3.1-107. Multiple outstanding transactions notice. A lender shall provide the following notice in a prominent place on each deferred deposit loan agreement in at least ten-point type:

> STATE LAW PROHIBITS DEFERRED DEPOSIT LOANS EXCEEDING FIVE HUNDRED DOLLARS ($500) TOTAL DEBT PLUS APPLICABLE FINANCE CHARGES PERMITTED BY LAW FROM A DEFERRED DEPOSIT LENDER. EXCEEDING THIS AMOUNT MAY CREATE FINANCIAL HARDSHIPS FOR YOU AND YOUR FAMILY. YOU HAVE THE RIGHT TO RESCIND THIS TRANSACTION BY 5 P.M. THE NEXT BUSINESS DAY FOLLOWING THIS TRANSACTION.

Source: L. 2000: Entire article added, p. 441, § 1, effective July 1. **L. 2001:** Entire section amended, p. 29, § 8, effective March 9.

5-3.1-108. Renewal - new loan - consecutive loans - payment plan - definitions. (1) A deferred deposit loan shall not be renewed more than once. After such renewal, the

consumer shall pay the debt in cash or its equivalent. If the consumer does not pay the debt, then the lender may deposit the consumer's instrument.

(2) Upon renewal of a deferred deposit loan, the lender may assess an additional finance charge not to exceed an annual percentage rate of forty-five percent. If the deferred deposit loan is renewed prior to the maturity date, the lender shall refund to the consumer a prorated portion of the finance charge based upon the ratio of time left before maturity to the loan term.

(3) A transaction is completed when the lender presents the instrument for payment or the consumer redeems the instrument by paying the full amount of the instrument to the holder. Once the consumer has completed the deferred deposit transaction, the consumer may enter into a new deferred deposit agreement with the lender. If the consumer's instrument is dishonored by the payor financial institution after the transaction is complete and, before the lender receives a notice of dishonor, the lender makes a new loan that does not exceed the maximum allowable loan, the lender shall not be in violation of the maximum loan amount provisions in section 5-3.1-106.

(4) Nothing in this section prohibits a lender from refinancing a deferred deposit loan as a supervised loan subject to the provision of this code, articles 1 to 9 of this title; except that the lender may not contract for or receive the minimum finance charge contained in section 5-2-201 (7).

(5) (Deleted by amendment, L. 2010, (HB 10-1351), ch. 267, p. 1223, § 6, effective August 11, 2010.)

Source: L. 2000: Entire article added, p. 441, § 1, effective July 1. **L. 2001:** (4) amended, p. 29, § 9, effective March 9. **L. 2004:** (3) amended, p. 318, § 4, effective July 1. **L. 2007:** (5) added, p. 384, § 1, effective July 1. **L. 2010:** (2) and (5) amended, (HB 10-1351), ch. 267, p. 1223, § 6, effective August 11.

Cross references: For the legislative declaration in the 2010 act amending subsections (2) and (5), see section 1 of chapter 267, Session Laws of Colorado 2010.

5-3.1-109. Form of loan proceeds. A lender may pay the proceeds from a deferred deposit loan to the consumer in the form of a business instrument, money order, cash, stored value card, internet transfer, or authorized automated clearinghouse transaction. The consumer shall not be charged an additional finance charge or fee for cashing the lender's business instrument or for negotiating forms of loan proceeds other than cash.

Source: L. 2000: Entire article added, p. 442, § 1, effective July 1. **L. 2004:** Entire section amended, p. 318, § 5, effective July 1.

5-3.1-110. Endorsement of instrument. A lender shall not negotiate or present an instrument for payment unless the instrument is endorsed with the actual business name of the lender.

Source: L. 2000: Entire article added, p. 442, § 1, effective July 1.

5-3.1-111. Redemption of instrument. Prior to the lender negotiating or presenting the instrument, the consumer shall have the right to redeem any instrument held by a lender as a result of a deferred deposit loan if the consumer pays the full amount of the instrument to the lender.

Source: L. 2000: Entire article added, p. 442, § 1, effective July 1.

5-3.1-112. Authorized dishonored instrument charge. If an instrument held by a lender as a result of a deferred deposit loan is returned unpaid to the lender from a payor financial institution due to insufficient funds, a closed account, a stop-payment order, or any other reason, not including a bank error, the lender shall have the right to exercise all civil

means authorized by law to collect the face value of the instrument; except that the provisions and remedies of section 13-21-109, C.R.S., are not applicable to any deferred deposit loan. In addition, the lender may contract for and collect one returned instrument charge for each deferred deposit loan, not to exceed twenty-five dollars, plus court costs and reasonable attorney fees as awarded by a court and incurred as a result of the default. However, such attorney fees shall not exceed the loan amount. The lender shall not collect any other fees as a result of default. A returned instrument charge shall not be allowed if the loan proceeds instrument is dishonored by the financial institution or the consumer places a stop-payment order due to forgery or theft.

Source: L. 2000: Entire article added, p. 442, § 1, effective July 1. **L. 2004:** Entire section amended, p. 318, § 6, effective July 1.

5-3.1-113. Posting of charges. Any lender offering a deferred deposit loan shall post at any place of business where deferred deposit loans are made a notice of the finance charges imposed for such deferred deposit loans.

Source: L. 2000: Entire article added, p. 442, § 1, effective July 1. **L. 2003:** Entire section amended, p. 1894, § 7, effective July 1.

5-3.1-114. Notice on assignment or sale of instruments. Prior to sale or assignment of instruments held by the lender as a result of a deferred deposit loan, the lender shall place a notice on the instrument in at least ten-point type to read:

THIS IS A DEFERRED DEPOSIT LOAN INSTRUMENT.

Source: L. 2000: Entire article added, p. 442, § 1, effective July 1.

5-3.1-115. Records and annual reports. A lender shall maintain records and file an annual report in accordance with section 5-2-304.

Source: L. 2000: Entire article added, p. 442, § 1, effective July 1. **L. 2001:** Entire section amended, p. 30, § 10, effective March 9.

5-3.1-116. License requirement. In accordance with section 5-2-301, no person shall engage in the business of deferred deposit loans without having first obtained a supervised lender's license pursuant to section 5-2-302. A separate license shall be required for each location where such business is conducted.

Source: L. 2000: Entire article added, p. 442, § 1, effective July 1. **L. 2001:** Entire section amended, p. 30, § 11, effective March 9.

5-3.1-117. Examination and investigation. A lender may be examined and investigated in accordance with section 5-2-305.

Source: L. 2000: Entire article added, p. 443, § 1, effective July 1. **L. 2001:** Entire section amended, p. 30, § 12, effective March 9.

5-3.1-118. Denial of license - discipline. (1) The administrator may deny a license or discipline a lender in accordance with sections 5-2-302, 5-2-303, and 5-2-306.

(2) (a) If the administrator finds that a lender has violated the code, articles 1 to 9 of this title, the administrator shall notify the lender in writing of such violations and the actions the lender must take to cure the violations. The administrator shall allow the lender thirty days after the postmark date of the notice, or the date of delivery if not mailed, to cure the violations before taking disciplinary action in accordance with subsection (1) of this

section. If the administrator determines that such lender has performed such actions contained in such notice, the lender shall not be liable for the violations that have been cured.

(b) This subsection (2) shall not apply if the lender violated the code, articles 1 to 9 of this title, in a repeated or willful manner.

(c) If an alleged violation of the code, articles 1 to 9 of this title, is the result of a bona fide clerical oversight or computer-based error and not the product of the lender's established lending practices, and the alleged violation can be corrected without material change to the terms and conditions of a consumer's loan, the lender shall have thirty days after the postmark date of the notice, or the date of delivery if not mailed, to cure the alleged violation without incurring any fine or penalty or any required refund of any finance charges associated with the alleged violation. Nothing in this subsection (2) shall exempt a lender from making required refunds if the violation resulted in an overcharge or excess charge to the consumer.

(3) A lender shall have ninety days to comply with any rule, interpretation, or opinion of the administrator that requires a lender to implement new policies or procedures that involve the reprinting of the lender's forms to include new disclosures, or that requires the lender to revise existing computer programs or add new computer programs to comply with the rule, interpretation, or opinion. During the ninety-day period, the administrator shall not deem the lender to be in violation of articles 1 to 9 of this title for noncompliance with the new rule, interpretation, or opinion.

Source: L. 2000: Entire article added, p. 443, § 1, effective July 1. **L. 2001:** (1) amended, p. 30, § 13, effective March 9. **L. 2004:** (2) amended and (3) added, p. 319, § 7, effective July 1.

5-3.1-119. Applicability of other provisions of this title. The provisions of the code, articles 1 to 9 of this title, apply to a lender unless such provisions are inconsistent with this article.

Source: L. 2000: Entire article added, p. 443, § 1, effective July 1.

5-3.1-120. Criminal culpability. A consumer shall not be subject to any criminal penalty for entering into a deferred deposit loan agreement. A consumer shall not be subject to any criminal penalty in the event the instrument is dishonored, unless the consumer's account on which the instrument was written was closed before the agreed upon date of negotiation, subject to the provisions of section 18-5-205, C.R.S.

Source: L. 2000: Entire article added, p. 443, § 1, effective July 1.

5-3.1-121. Unfair or deceptive practices. (1) No person shall engage in unfair or deceptive acts, practices, or advertising in connection with a deferred deposit loan.

(2) A person violates the requirements of this article by engaging in any act that limits or restricts the application of this article, including making loans disguised as personal property, personal sales, and leaseback transactions or by disguising loan proceeds as cash rebates for the pretextual installment sale of goods and services.

Source: L. 2000: Entire article added, p. 443, § 1, effective July 1. **L. 2010:** Entire section amended, (HB 10-1351), ch. 267, p. 1224, § 7, effective August 11.

Cross references: For the legislative declaration in the 2010 act amending this section, see section 1 of chapter 267, Session Laws of Colorado 2010.

5-3.1-122. Unconscionability. (1) In applying the provisions of sections 5-5-109 and 5-6-112 to the actions of a lender, consideration shall be given to the following, among other factors:

(a) The financial benefits of the loan to the consumer and the level of risk incurred by the lender in extending credit;

(b) The absence of collateral other than the instrument executed by the consumer payable to the lender;

(c) The relation between the amount and terms of credit granted and the cost of making the loan.

(2) A lender shall require a consumer to fill out a loan application at least once in each twelve-month period of time and shall maintain this application on file. The application shall be signed and dated by the consumer.

(3) (a) A lender shall require the consumer to provide a pay stub or other evidence of income at least once each twelve-month period. Such evidence shall not be over forty-five days old when presented. If a lender requires a consumer to present a bank statement to secure a loan, the lender shall allow the consumer to delete from the statement the information regarding to whom the debits listed on the statement were payable.

(b) If the amount borrowed is not more than twenty-five percent of the consumer's monthly gross income and benefits, as evidenced by a paycheck stub or otherwise substantiated, a lender shall not be obligated to investigate the consumer's continued debt position, and the consumer's ability to repay the loan need not be further demonstrated.

(4) If a lender complies with the requirements of subsections (2) and (3) of this section, and the deferred deposit loan otherwise complies with this article and other applicable law, neither the consumer's inability to repay the loan nor the lender's decision to obtain or not obtain additional information concerning the consumer's creditworthiness shall be cause to determine that a loan is unconscionable.

Source: L. 2004: Entire section added, p. 320, § 8, effective July 1.

5-3.1-123. Use of multiple agreements for deferred deposit loans. If a consumer obtains a deferred deposit loan voluntarily and separately from his or her spouse and the consumer's action is documented in writing, signed by the consumer, and retained by the lender, the transaction shall not be considered a violation of section 5-3-205.

Source: L. 2004: Entire section added, p. 320, § 9, effective July 1.

ARTICLE 3.5

Consumer Equity Protection

Law reviews: For article, "The Colorado Equity Protection Act: A Response to Predatory Lending Practices", see 32 Colo. Law. 79 (April 2003).

PART 1

OBLIGOR PROTECTION

PART 2

ENFORCEMENT AND LIABILITY

PART 3

MISCELLANEOUS PROVISIONS

PART 1

OBLIGOR PROTECTION

5-3.5-101. Definitions. As used in this article, unless the context otherwise requires:

(1) "Bridge loan" means temporary or short-term financing with a maturity of less than eighteen months that requires payments of only interest until the entire unpaid balance is due and payable.

(2) "Covered loan" means a consumer credit transaction secured by property located within this state that is considered a mortgage under section 152 of the federal "Home Ownership and Equity Protection Act of 1994", 15 U.S.C. sec. 1602 (aa), as amended, and regulations adopted pursuant thereto by the federal reserve board, including, without limitation, 12 CFR 226.32, as amended; except that, if the total points and fees paid by the obligor at or before closing exceed six percent of the total loan amount, such loan shall be deemed to be a covered loan if the transaction otherwise meets the requirements of this subsection (2).

(3) "Lender" means any individual or entity that originates one or more covered loans. The individual or entity to whom a covered loan is initially payable, either on the face of the note or contract or by agreement when there is no note or contract, shall be deemed to be the lender.

(4) "Mortgage broker" means a person other than an employee or exclusive agent of a lender who, for compensation, brings an obligor and lender together to obtain a covered loan.

(5) "Obligor" means each obligor, co-obligor, co-signer, or grantor obligated to repay a covered loan.

(6) "Political subdivision" means a county, city and county, city, town, service authority, school district, local improvement district, law enforcement authority, city or county housing authority, or water, sanitation, fire protection, metropolitan, irrigation, drainage, or other special district or any other kind of municipal, quasi-municipal, or public corporation organized pursuant to law.

(7) "Principal balance" means the amount financed plus prepaid finance charges as defined in the federal "Truth in Lending Act", 15 U.S.C. sec. 1601 et. seq., as amended.

(8) "Servicer" has the same meaning as set forth in section 2605 (i) (2) of the federal "Real Estate Settlement Procedures Act of 1974", 12 U.S.C. sec. 2601 et. seq., as amended.

Source: L. 2002: Entire article added, p. 1594, § 1, effective June 7. **L. 2003:** (2) amended, p. 1894, § 8, effective July 1.

5-3.5-102. Protection of obligors. (1) A covered loan is subject to the following limitations:

(a) **Limitation on balloon payment.** No covered loan may contain a provision for a scheduled payment that is more than twice as large as the average of earlier regularly scheduled payments, unless such balloon payment becomes due and payable not less than one hundred twenty months after the date of execution of the loan. This prohibition does not apply when the payment schedule is adjusted to account for the seasonal or irregular income of the obligor or if the purpose of the loan is a bridge loan connected with, or related to, the acquisition or construction of a dwelling intended to become the obligor's principal dwelling.

(b) **No call provision.** No covered loan may contain a call provision that permits the lender, in its sole discretion, to accelerate the indebtedness. This prohibition shall not apply when:

(I) Acceleration of repayment of the loan is justified:

(A) By default in which the obligor fails to meet the repayment terms of the agreement for any outstanding balance; or

(B) Pursuant to a due-on-sale provision;

(II) There is fraud or material misrepresentation by an obligor in connection with the loan;

(III) There is a provision permitting acceleration if the lender, in good faith, believes itself to be materially insecure or believes that the prospect of future payment has become materially impaired; or

(IV) There is any action or inaction by the obligor that adversely affects the lender's security for the loan or any rights of the lender in such security.

(c) **No negative amortization.** No covered loan may contract for a payment schedule with regular periodic payments that cause the principal balance to increase; except that this paragraph (c) shall not prohibit negative amortization as a consequence of a temporary forbearance or restructure sought by the obligor.

(d) **No increased interest rate upon default.** No covered loan may contract for any increase in the interest rate as a result of a default; except that this paragraph (d) shall not apply to periodic interest rate changes in a variable rate loan that is otherwise consistent with the provisions of the loan agreement if the change in the interest rate is not occasioned by the event of default or a permissible acceleration of the indebtedness.

(e) **Limitations on mandatory arbitration clauses.** No covered loan may be subject to a mandatory arbitration clause that:

(I) Does not comply with rules set forth by a nationally recognized arbitration organization such as the American arbitration association;

(II) Does not require the arbitration proceeding to be conducted:

(A) Within the federal judicial district in which the subject property is located;

(B) In the city nearest the obligor's residence where a federal district court is located; or

(C) At such other location as may be mutually agreed upon by the parties;

(III) Does not require the lender to contribute at least fifty percent of the amount of any filing fee; and

(IV) Does not require the lender to pay standard daily arbitration fees, both its own and those of the obligor, for at least the first day of arbitration.

(f) **No advance payments.** No covered loan may include terms under which any periodic payments required under the loan are paid in advance from the loan proceeds provided to the obligor.

(g) **Limitations on prepayment fees.** (I) **First thirty-six months only.** A prepayment fee or penalty shall be permitted only on a refinance to a different lender other than pursuant to a sale and only during the first thirty-six months after the date of execution of a covered loan. Prepayment fees and penalties shall not exceed six months' interest for prepayment within the first three years of the loan. The prepayment fees or penalties permitted by this paragraph (g) shall apply only to covered loans that are secured by a first mortgage, deed of trust, or security interest to refinance, by amendment, payoff, or otherwise, an existing loan made to finance the acquisition or construction of a dwelling, including a refinance loan providing additional sums of money for any purpose, regardless of whether related to acquisition or construction. No prepayment fees or penalties shall be included in the loan documents or charged to the obligor for prepayment:

(A) After the third year of the loan;

(B) Pursuant to a refinance with the same lender; or

(C) That is partial.

(II) **No prepayment fees for certain refinancing.** No prepayment fee or penalty may be charged on a refinancing of a covered loan if the covered loan being refinanced is owned by the refinancing lender at the time of such refinancing.

(III) **Lender must offer choice.** A lender shall not include a prepayment penalty fee in a covered loan unless the lender offers the obligor the option of choosing a loan product without a prepayment penalty fee. A lender shall be deemed to have complied with this requirement if the obligor receives and executes the following disclosure, which may be incorporated with any other required disclosure:

LOAN PRODUCT CHOICE

I was provided with an offer to accept a product both with and without a prepayment penalty provision. I have chosen to accept the product ________ with / ________ without a prepayment penalty.

Source: L. 2002: Entire article added, p. 1595, § 1, effective June 7. **L. 2003:** (1)(a) amended, p. 1894, § 9, effective July 1.

5-3.5-103. Restricted acts and practices. (1) The following acts and practices are prohibited in the making of a covered loan:

(a) **No lending without cautionary notice.** (I) A lender may not make a covered loan unless the lender or a mortgage broker has given the following notice, or a substantially similar notice, in writing to the obligor within a reasonable period of time after determining that the loan would result in a covered loan, but no later than the time by which the notice is required under the notice provision contained in 12 CFR 226.31 (c), as amended:

CONSUMER CAUTION

If you obtain this loan, the lender will have a mortgage in Colorado; this is a deed of trust on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan. Mortgage loan rates and closing costs and fees vary based on many factors, including your particular credit and financial circumstances, your earnings history, the loan-to-value requested, and the type of property that will secure your loan. The loan rate and fees could vary based on which lender or broker you select.

You are not required to complete any loan agreement merely because you have received these disclosures or have signed a loan application. If you proceed with this mortgage loan, you should also remember that you may face serious financial risks if you use this loan to pay off credit card debts and other debts in connection with this transaction and then later incur significant new credit card charges or other debts. If you continue to accumulate debt after this loan is closed and then experience financial difficulties, you could lose your home and any equity you have in it if you do not meet your mortgage loan obligations.

Property taxes and homeowner's insurance are your responsibility. Not all lenders provide escrow services for these payments. You should ask your lender about these services.

Your payments on existing debts contribute to your credit ratings. You should not accept any advice to ignore your regular payments to your existing creditors.

(II) It shall be a rebuttable presumption that a lender or broker has met its obligation to provide this disclosure if the consumer provides the lender or broker with a signed acknowledgment of receipt of a copy of the notice set forth in subparagraph (I) of this paragraph (a).

(b) **No lending without due regard to repayment ability.** (I) A lender may not make a covered loan to a consumer based on the consumer's collateral without regard to the consumer's repayment ability, including the consumer's current and expected income, current obligations, and employment.

(II) There is a presumption that a creditor has violated this paragraph (b) if the creditor engages in a pattern or practice of making loans subject to 12 CFR 226.32 without verifying and documenting consumers' repayment abilities.

(III) (A) In the case of a stated income loan, the reasonable basis for believing that there are sufficient funds to support the covered loan may not be based solely on the income stated by the obligor, but may include other information in the possession of the lender after the solicitation of all information that the lender customarily solicits in connection with stated income loans. A lender shall not knowingly or willfully originate a covered loan as a stated income loan with the intent of evading this subparagraph (III).

(B) A person who willfully and knowingly gives false or inaccurate information or fails to provide information that the person is required to disclose pursuant to applicable law may have violated and may be subject to penalties established in 15 U.S.C. sec. 1611.

(c) **Refinancing within a one-year period.** Within one year after having extended credit subject to this article, no lender shall refinance any covered loan to the same obligor into another covered loan unless the refinancing is in the obligor's interest. An assignee holding or servicing an extension of mortgage credit subject to this article shall not, for the remainder of the one-year period following the date of origination of the credit, refinance

any covered loan to the same obligor into another covered loan unless the refinancing is in the obligor's interest. A creditor or assignee shall not engage in acts or practices to evade this paragraph (c), including a pattern or practice of arranging for the refinancing of its own loans by affiliated or unaffiliated creditors, or modifying a loan agreement, regardless of whether the existing loan is satisfied and replaced by the new loan, and charging a fee.

(d) **No refinancing certain low-rate loans.** A lender shall not replace or consolidate a zero interest rate, or other low-rate, loan made by a governmental or nonprofit lender with a covered loan within the first ten years after the low-rate loan was made unless the current holder of the loan consents in writing to the refinancing. For purposes of this paragraph (d), a "low-rate" loan is a loan that carries a current interest rate two percentage points or more below the current yield on United States department of the treasury securities with a comparable maturity. If the loan's current interest rate is either a discounted introductory rate or a rate that automatically steps up over time, then the fully-indexed rate or the fully stepped-up rate, as appropriate, should be used in lieu of the current rate to determine whether a loan is a low-rate loan.

(e) **Restrictions on covered loan proceeds to pay home improvement contracts.** A lender shall not pay a contractor under a home-improvement contract from the proceeds of a covered loan other than by an instrument payable to the obligor or jointly to the obligor and the contractor or, at the election of the obligor, through a third-party escrow agent in accordance with terms established in a written agreement signed by the obligor, the lender, and the contractor prior to the disbursement of funds to the contractor.

(f) **No financing of credit insurance.** No covered loan may include, directly or indirectly, financing of any premiums for any credit life, credit disability, credit property, or credit unemployment insurance, any other life or health insurance products, or any payments for any debt cancellation or suspension agreement or contracts; except that calculated insurance premiums or debt cancellation or suspension fees paid on a monthly basis shall not be considered to have been financed by the lender for purposes of this paragraph (f).

(g) **No recommending default.** No lender shall recommend or encourage default on an existing loan or other debt prior to and in connection with the closing or planned closing of a covered loan that refinances all or any portion of such existing loan or debt.

(h) **No fee for payoff quote.** No creditor may charge a fee for informing or transmitting to any person the balance due to pay off a covered loan or to provide a release upon prepayment. A creditor shall provide a payoff balance within a reasonable time after a request, but in any event not more than five business days after a written request.

Source: L. 2002: Entire article added, p. 1597, § 1, effective June 7. **L. 2003:** (1)(c) amended, p. 1894, § 10, effective July 1.

5-3.5-104. Reporting to credit bureaus. A lender or its servicer shall report at least quarterly both the favorable and unfavorable payment history information of the obligor on payments due to the lender on a covered loan to a nationally recognized consumer credit reporting agency. This section shall not prevent a lender or its servicer from agreeing with the obligor not to report specified payment history information in the event of a resolved or unresolved dispute with an obligor, and shall not apply to covered loans held or serviced by a lender for less than ninety days.

Source: L. 2002: Entire article added, p. 1600, § 1, effective June 7.

PART 2

ENFORCEMENT AND LIABILITY

5-3.5-201. Enforcement - liability. The attorney general and any obligor of a covered loan may enforce this article with respect to such covered loan in the manner provided for violations of the federal "Home Ownership and Equity Protection Act of 1994", 15 U.S.C. sec. 1639, and regulations adopted pursuant thereto by the federal reserve board, including,

without limitation, 12 CFR 226.32, as set forth in the federal "Truth in Lending Act", 15 U.S.C. sec. 1640, and regulations adopted pursuant thereto by the federal reserve board, including the provisions on civil liability, class actions, rescission, correction, and bona fide error. Persons engaged in the purchase, sale, assignment, securitization, or servicing of covered loans shall be liable under this article for the action or inaction of persons originating such loans only in the manner and to the extent provided for violation of the federal "Home Ownership and Equity Protection Act of 1994" and the federal "Truth in Lending Act", 15 U.S.C. sec. 1641, and regulations adopted pursuant thereto by the federal reserve board.

Source: L. 2002: Entire article added, p. 1600, § 1, effective June 7.

PART 3

MISCELLANEOUS PROVISIONS

5-3.5-301. Effective date - applicability. Section 5-3.5-303 is intended to restate and confirm the existing law of this state, namely that the laws of this state relating to the financial and lending activities are to be applied on a uniform, statewide basis. Parts 1 and 2 of this article shall take effect January 1, 2003. This part 3 shall take effect upon passage. This article shall apply to covered loans offered or entered into on or after January 1, 2003.

Source: L. 2002: Entire article added, p. 1601, § 1, effective June 7.

5-3.5-302. Severability. The provisions of this article are severable and if any of its provisions are held unconstitutional, the decision of the court shall not affect or impair any of the remaining provisions of this article. It is hereby declared to be the legislative intent that this article would have been adopted if the unconstitutional provisions had not been included.

Source: L. 2002: Entire article added, p. 1601, § 1, effective June 7.

5-3.5-303. Relationship to other laws. (1) **General rule.** All political subdivisions of this state, including municipalities, shall be prohibited from enacting and enforcing ordinances, resolutions, and regulations pertaining to lending activities.

(2) **Preemption.** Any provision of this article preempted by federal law with respect to a national bank or federal savings association shall also, to the same extent, not apply to an operating subsidiary of a national bank or federal savings association that satisfies the requirements for operating subsidiaries established in 12 CFR 5.34, relating to operating subsidiaries, or 12 CFR 559.3, relating to the characteristics of and requirements for subordinate organizations of federal savings associations, nor to a bank chartered under the laws of Colorado or any operating subsidiary of such a state chartered bank.

(3) **Interpretation.** The provisions of this article shall be interpreted and applied to the fullest extent practical in a manner consistent with applicable federal laws and regulations, and shall not be deemed to constitute an attempt to override federal law.

Source: L. 2002: Entire article added, p. 1601, § 1, effective June 7.

ARTICLE 3.7

Consumer Credit Solicitation Protection

5-3.7-101. Consumer credit solicitation protection - definitions. (1) A solicitor that makes a firm offer of credit for a lender credit card or a seller credit card to a consumer by mail solicitation and receives an acceptance of that offer that lists the address of the consumer accepting the offer as different from the address to which the offer was sent shall, prior to issuing or directing issuances of the lender credit card or seller credit card, verify that the consumer accepting the offer is the same consumer to whom the offer was sent.

(2) As used in this section, unless the context otherwise requires:

(a) "Firm offer of credit" shall have the same meaning as set forth in 15 U.S.C. sec. 1681a (l).

(b) "Solicitor" means the person making the offer by mail solicitation and does not include a card issuer or other creditor when that creditor or card issuer relies on an independent third party to provide the services.

(c) "Verify" means the use of commercially reasonable efforts to ascertain that the consumer responding to a mail solicitation is the same consumer to whom the solicitation was directed. For the purposes of this article, a solicitor shall be deemed to verify that the consumer accepting a mail solicitation is the same consumer to whom the solicitation was directed if:

(I) A consumer responding at a telephone number appearing in a publicly available directory or database as the telephone number of the consumer to whom the solicitation was mailed identifies himself or herself as the consumer to whom the solicitation was mailed and acknowledges the consumer's acceptance of the solicitation; or

(II) A consumer presents the solicitor, including presentation by facsimile transmission or mail, the original or a copy of one or more documents, including a driver's license, social security card, passport, or any other identification document issued by a state or federal governmental agency, that, on the face of the document or documents, appears to confirm such consumer's identity as the consumer to whom a solicitation was mailed and the consumer acknowledges acceptance of the solicitation; or

(III) The solicitor verified, by any means adopted in federal regulations, that the consumer accepting the solicitation is the consumer to whom the solicitation was directed; or

(IV) The solicitor verified by any other means, that under the standards and practices of the industry in which the solicitor is engaged would be deemed sufficient, that the consumer accepting the solicitation is the same consumer to whom the solicitation was sent.

Source: L. 2004: Entire article added, p. 657, § 1, effective July 1.

ARTICLE 4

Insurance

Editor's note: This article was numbered as article 4 of chapter 73, C.R.S. 1963. This title was repealed and reenacted in 1971, and this article was subsequently repealed and reenacted in 2000, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 2000, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume and the editor's note following the title heading. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated. For a detailed comparison of this article, see the comparative tables located in the back of the index.

PART 1

INSURANCE IN GENERAL

PART 1

INSURANCE IN GENERAL

5-4-101. Short title. This article shall be known and may be cited as "Uniform Consumer Credit Code - Insurance".

Source: L. 2000: Entire article R&RE, p. 1225, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-101, as it existed prior to 2000.

5-4-102. Scope - relation to credit insurance act - applicability to parties. (1) This article applies to insurance provided or to be provided in relation to a consumer credit transaction.

(2) This article supplements and does not repeal the "Credit Insurance Act", article 10 of title 10, C.R.S. The provisions of this code concerning administrative controls, liabilities, and penalties do not apply to persons acting as insurers, and the similar provisions of the "Credit Insurance Act" do not apply to creditors and consumers.

Source: L. 2000: Entire article R&RE, p. 1225, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-102, as it existed prior to 2000.

5-4-103. Definitions - "consumer credit insurance" - "Credit Insurance Act". As used in this code, unless the context otherwise requires:

(1) "Consumer credit insurance" means insurance, other than insurance on property, by which the satisfaction of debt in whole or in part is a benefit provided but does not include:

(a) Insurance, as to which a finance charge is imposed and provided in relation to a credit transaction in which a payment is scheduled more than ten years after the extension of credit;

(b) Insurance issued as an isolated transaction on the part of the insurer not related to an agreement or plan for insuring consumers of the creditor; or

(c) Insurance indemnifying the creditor against loss due to the consumer's default.

(2) "Credit Insurance Act" means the "Credit Insurance Act", article 10 of title 10, C.R.S.

Source: L. 2000: Entire article R&RE, p. 1225, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-103, as it existed prior to 2000.

5-4-104. Creditor's provision of and charge for insurance - excess amount of charge. (1) Except as otherwise provided in this article and subject to the provisions on additional charges contained in section 5-2-202 and maximum charges contained in section 5-2-201, a creditor may agree to provide insurance and may contract for and receive a charge for insurance separate from and in addition to other charges. A creditor need not make a separate charge for insurance provided or required by the creditor. This code does not authorize the issuance of any insurance prohibited under any statute, or rule thereunder, governing the business of insurance.

(2) The excess amount of a charge for insurance provided for in agreements in violation of this article is an excess charge for the purposes of:

(a) The provisions on remedies and penalties contained in article 5 of this title as to effect of violations on rights of parties under section 5-5-201; and

(b) The provisions on administration contained in article 6 of this title as to civil actions by the administrator under section 5-6-114.

Source: L. 2000: Entire article R&RE, p. 1225, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-104, as it existed prior to 2000.

5-4-105. Conditions applying to insurance to be provided by creditor. (1) If a creditor agrees with a consumer to provide insurance:

(a) The insurance shall be evidenced by an individual policy or certificate of insurance delivered to the consumer or sent to the consumer at his or her address as stated by the consumer within thirty days after the term of the insurance commences under the agreement between the creditor and consumer; or

(b) The creditor shall promptly notify the consumer of any failure or delay in providing the insurance.

Source: L. 2000: Entire article R&RE, p. 1226, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-105, as it existed prior to 2000.

5-4-106. Unconscionability. (1) In applying the provisions of this code on unconscionability contained in sections 5-5-109 and 5-6-112 to a separate charge for insurance, consideration shall be given, among other factors, to:

(a) Potential benefits to the consumer including the satisfaction of the consumer's obligations;

(b) The creditor's need for the protection provided by the insurance; and

(c) The relation between the amount and terms of credit granted and the insurance benefits provided.

(2) If consumer credit insurance otherwise complies with this article and other applicable law, neither the amount nor the term of the insurance nor the amount of a charge therefor is in itself unconscionable.

Source: L. 2000: Entire article R&RE, p. 1226, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-106, as it existed prior to 2000.

5-4-107. Maximum charge by creditor for insurance. (1) Except as provided in subsection (2) of this section, if a creditor contracts for or receives a separate charge for insurance, the amount charged to the consumer for the insurance may not exceed the premium to be charged by the insurer as computed at the time the charge to the consumer is determined conforming to any rate filings required by law and made by the insurer with the commissioner of insurance.

(2) A creditor who provides consumer credit insurance in relation to a revolving credit account may calculate the charge to the consumer in each billing cycle by applying the current premium rate to:

(a) The average daily unpaid balance of the debt in the cycle;

(b) The unpaid balance of the debt or a median amount within a specified range of unpaid balances of debt on approximately the same day of the cycle. The day of the cycle need not be the day used in calculating the finance charge, but the specified range shall be the range used for that purpose; or

(c) The unpaid balances of the amount financed calculated according to the actuarial method.

Source: L. 2000: Entire article R&RE, p. 1227, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-107, as it existed prior to 2000.

5-4-108. Refund or credit required - amount. (1) (a) Except as provided in subsection (3) of this section, an appropriate refund or credit of unearned premiums shall be made to the person entitled thereto with respect to any separate charge made to the consumer for insurance if:

(I) The insurance is not provided or is provided for a shorter term than that for which the charge to the consumer for insurance was computed; or

(II) The insurance terminates prior to the end of the term for which it was written because of prepayment in full of the indebtedness or the insurance terminates for any other reason.

(b) All consumer credit insurance shall terminate upon prepayment in full of the indebtedness.

(2) If a refund or credit of unearned premiums is required pursuant to the provisions of subsection (1) of this section:

(a) The original creditor, if he or she is the holder of the indebtedness at the time of prepayment, shall either promptly make the appropriate refund or credit or shall promptly notify the consumer and the insurer in writing that a refund or credit is due. Upon the receipt of notice that a refund or credit is due, the insurer shall promptly make an appropriate refund or credit of unearned premiums pursuant to the provisions of section 10-10-110 (2), C.R.S. For purposes of this section, "original creditor" means the person to whom the indebtedness was initially payable, and "insurer" means every person engaged as principal, indemnitor, surety, or contractor in the business of making contracts of insurance, excluding any licensed insurance agent.

(b) (I) The assignee, if the indebtedness has been assigned, shall either promptly make the appropriate refund or credit or shall promptly notify the consumer, the original creditor, and the insurer, if known, in writing that a refund or credit is due. For the purposes of this section, "assignee" means a person other than the original creditor who at the time of prepayment holds the indebtedness.

(II) The original creditor, upon receipt of notice pursuant to subparagraph (I) of this paragraph (b), shall either promptly make the appropriate refund or credit or shall promptly notify the insurer in writing that a refund or credit of unearned premiums is due.

(c) The insurer, upon the receipt of notice that a refund or credit is due pursuant to paragraph (a) or (b) of this subsection (2), shall make an appropriate refund or credit of unearned premiums pursuant to the provisions of section 10-10-110 (2), C.R.S., and subsection (1) of this section.

(d) An assignee or original creditor gives notice pursuant to this section upon delivery or mailing of the notice to the last address provided to him or her. Once an original creditor or an assignee has notified the appropriate party, as provided in paragraphs (a) and (b) of this subsection (2), the original creditor and the assignee shall have no further obligations.

(3) This article does not require a refund or credit of unearned premiums if:

(a) All refunds and credits due to the debtor under this article amount to less than one dollar; or

(b) The charge for insurance is computed from time to time on the outstanding balance of the indebtedness and the charge relates to only one premium period.

(4) Except as otherwise required, a refund or credit is not required because:

(a) The insurance is terminated by payment of proceeds under the policy; or

(b) The original creditor or assignee pays or accounts for premiums to the insurer in the amounts and at the times determined by the agreement between them; or

(c) The original creditor or assignee receives directly or indirectly under any policy of insurance a gain or advantage not prohibited by law.

(5) If a single type of insurance is terminated by the payment of proceeds under the policy pursuant to paragraph (a) of subsection (4) of this section, a refund or credit of unearned premiums for all other types of consumer credit insurance issued on the same indebtedness shall be made if so required by the provisions of this section and section 10-10-110 (2), C.R.S.

(6) A refund or credit required by subsection (1) of this section is appropriate as to amount if it is computed according to a method prescribed or approved by the commissioner of insurance or a formula filed by the insurer with the commissioner of insurance at least thirty days before the consumer's right to a refund or credit becomes determinable unless the method or formula is employed after the commissioner of insurance notifies the insurer that he or she disapproves it.

Source: L. 2000: Entire article R&RE, p. 1227, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-108, as it existed prior to 2000.

5-4-109. Existing insurance - choice of insurer. If a creditor requires insurance, upon notice to the creditor the consumer shall have the option of providing the required insurance through an existing policy of insurance owned or controlled by the consumer or through a policy to be obtained and paid for by the consumer, but the creditor may for reasonable cause decline the insurance provided by the consumer.

Source: L. 2000: Entire article R&RE, p. 1229, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-109, as it existed prior to 2000.

5-4-110. Charge for insurance in connection with a deferral, refinancing, or consolidation - duplicate charges. (1) A creditor may not contract for or receive a separate charge for insurance in connection with a deferral described in section 5-2-204, a refinancing described in section 5-2-205, or a consolidation described in section 5-2-206 unless:

(a) The consumer agrees at or before the time of the deferral, refinancing, or consolidation that the charge may be made;

(b) The consumer is or is to be provided with insurance for an amount or a term, or insurance of a kind, in addition to that to which the consumer would have been entitled had there been no deferral, refinancing, or consolidation;

(c) The consumer receives a refund or credit on account of any unexpired term of existing insurance in the amount that would be required if the insurance were terminated under section 5-4-108; and

(d) The charge does not exceed the amount permitted under section 5-4-107.

(2) A creditor may not contract for or receive a separate charge for insurance that duplicates insurance with respect to which the creditor has previously contracted for or received a separate charge.

Source: L. 2000: Entire article R&RE, p. 1229, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-110, as it existed prior to 2000.

5-4-111. Cooperation between administrator and commissioner of insurance. The administrator and the commissioner of insurance are authorized and directed to consult and assist one another in maintaining compliance with this article. They may jointly pursue investigations, prosecute suits, and take other official action, as may seem to them appropriate, if either of them is otherwise empowered to take the action. If the administrator is informed of a violation or suspected violation by an insurer of this article or of the insurance laws, rules, and regulations of this state, the administrator shall advise the commissioner of insurance of the circumstances.

Source: L. 2000: Entire article R&RE, p. 1229, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-111, as it existed prior to 2000.

5-4-112. Administrative action of commissioner of insurance. (1) To the extent that the commissioner's responsibility under this article requires, the commissioner of insurance shall promulgate rules in accordance with article 4 of title 24, C.R.S., with respect to insurers, and with respect to refunds described in section 5-4-108, and, in case of violation, may make an order for compliance.

(2) Sections 24-4-102 to 24-4-106, C.R.S., apply to and govern all administrative action taken by the commissioner of insurance pursuant to this section.

Source: L. 2000: Entire article R&RE, p. 1230, § 1, effective July 1. **L. 2003:** (1) amended, p. 1895, § 11, effective July 1.

Editor's note: This section is similar to former § 5-4-112, as it existed prior to 2000.

PART 2

CONSUMER CREDIT INSURANCE

5-4-201. Term of insurance. (1) Consumer credit insurance provided by a creditor may be subject to the furnishing of evidence of insurability satisfactory to the insurer. Whether or not such evidence is required, the term of the insurance shall commence no later than when the consumer becomes obligated to the creditor or when the consumer applies for the insurance, whichever is later, except as follows:

(a) If any required evidence of insurability is not furnished until more than thirty days after the term would otherwise commence, the term may commence on the date when the insurer determines the evidence to be satisfactory; or

(b) If the creditor provides insurance not previously provided covering debts previously created, the term may commence on the effective date of the policy.

(2) The originally scheduled term of the insurance shall extend at least until the due date of the last scheduled payment of the debt except as follows:

(a) If the insurance relates to a revolving credit account, the term need extend only until the payment of the debt under the account and may be sooner terminated after at least thirty days' notice to the consumer; or

(b) If the consumer is advised in writing that the insurance will be written for a specified shorter time, the term need extend only until the end of the specified time.

(3) The term of the insurance shall not extend more than thirty days after the originally scheduled due date of the last scheduled payment of the debt unless it is extended without additional cost to the consumer or as an incident to a deferral, refinancing, or consolidation.

Source: L. 2000: Entire article R&RE, p. 1230, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-201, as it existed prior to 2000.

5-4-202. Amount of insurance. (1) Except as provided in subsection (2) of this section:

(a) In the case of consumer credit insurance providing life coverage, the amount of insurance may not initially exceed the debt and, if the debt is payable in installments, may not at any time exceed the greater of the scheduled or actual amount of the debt; or

(b) In the case of any other consumer credit insurance, the total amount of periodic benefits payable may not exceed the total of scheduled unpaid installments of the debt, and the amount of any periodic benefit may not exceed the original amount of debt divided by the number of periodic installments in which it is payable.

(2) If consumer credit insurance is provided in connection with a revolving credit account, the amounts payable as insurance benefits may be reasonably commensurate with the amount of debt as it exists from time to time. If consumer credit insurance is provided in connection with a commitment to grant credit in the future, the amounts payable as insurance benefits may be reasonably commensurate with the total from time to time of the amount of debt and the amount of the commitment.

Source: L. 2000: Entire article R&RE, p. 1231, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-202, as it existed prior to 2000.

5-4-203. Filing and approval of rates and forms. (1) A creditor may not use a form or charge in connection with credit insurance that does not comply with section 10-10-109, C.R.S.

(2) and (3) (Deleted by amendment, L. 2003, p. 1895, § 12, effective July 1, 2003.)

Source: L. 2000: Entire article R&RE, p. 1231, § 1, effective July 1. **L. 2001:** (2) amended, p. 894, § 5, effective June 1. **L. 2003:** Entire section amended, p. 1895, § 12, effective July 1.

Editor's note: This section is similar to former § 5-4-203, as it existed prior to 2000.

PART 3

PROPERTY AND LIABILITY INSURANCE

5-4-301. Property insurance. (1) A creditor may not contract for or receive a separate charge for insurance against loss of or damage to property unless:

(a) The insurance covers a substantial risk of loss of or damage to property related to the credit transaction;

(b) The amount, terms, and conditions of the insurance are reasonable in relation to the character and value of the property insured or to be insured; and

(c) The term of the insurance is reasonable in relation to the terms of credit.

(2) The term of the insurance is reasonable if it is customary and does not extend substantially beyond a scheduled maturity.

(3) A creditor may not contract for or receive a separate charge for insurance against loss of or damage to property unless the amount financed exclusive of charges for the insurance is one thousand dollars or more and the value of the property is one thousand dollars or more.

Source: L. 2000: Entire article R&RE, p. 1232, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-301, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968).

5-4-302. Insurance on creditor's interest only. If a creditor contracts for or receives a separate charge for insurance against loss of or damage to property, the risk of loss or damage not willfully caused by the consumer is on the consumer only to the extent of any deficiency in the effective coverage of the insurance even though the insurance covers only the interest of the creditor.

Source: L. 2000: Entire article R&RE, p. 1232, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-302, as it existed prior to 2000.

ANNOTATION

A creditor named as a beneficiary in a policy on the debtor's life is entitled out of the proceeds only to the amount of the actual debt, together with interest. Where the sole purpose to be accomplished in the issuance of an insurance policy upon the life of a debtor is to secure the payment of a debt to the creditor, or where the same single purpose is accomplished by a change in beneficiary, the creditor's right to the proceeds of the policy on the death of a debtor extends no further than indemnity. Under such circumstances all proceeds from the policy beyond the debt owed the creditor plus interest and premiums paid by him, are payable to the legal representatives of the deceased debtor. Forster v. Franklin Life Ins. Co., 135 Colo. 383, 311 P.2d 700 (1957) (decided under repealed § 73-5-1, CRS 53).

5-4-303. Liability insurance. A creditor may not contract for or receive a separate charge for insurance against liability unless the insurance covers a substantial risk of liability arising out of the ownership or use of property related to the credit transaction.

Source: L. 2000: Entire article R&RE, p. 1232, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-303, as it existed prior to 2000.

5-4-304. Cancellation by creditor. This section does not apply to an insurance premium loan. A creditor shall not request cancellation of a policy of property or liability insurance except after the consumer's default or in accordance with a written authorization by the consumer, and in either case the cancellation does not take effect until written notice is delivered to the consumer or mailed to the consumer at his or her address as stated by the consumer. The notice shall state that the policy may be canceled on a date not less than ten days after the notice is delivered or, if the notice is mailed, not less than thirteen days after it is mailed.

Source: L. 2000: Entire article R&RE, p. 1233, § 1, effective July 1.

Editor's note: This section is similar to former § 5-4-304, as it existed prior to 2000.

ARTICLE 5

Remedies and Penalties

Editor's note: This article was numbered as article 5 of chapter 73, C.R.S. 1963. This title was repealed and reenacted in 1971, and this article was subsequently repealed and reenacted in 2000, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 2000, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973

beginning on page vii in the front of this volume and the editor's note following the title heading. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated. For a detailed comparison of this article, see the comparative tables located in the back of the index.

PART 1

LIMITATIONS ON CREDITORS' REMEDIES

PART 2

CONSUMERS' REMEDIES

PART 3

CRIMINAL PENALTIES

PART 1

LIMITATIONS ON CREDITORS' REMEDIES

5-5-101. Short title. This article shall be known and may be cited as the "Uniform Consumer Credit Code - Remedies and Penalties".

Source: L. 2000: Entire article R&RE, p. 1233, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-101, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Legislative Overview of the Uniform Consumer Credit Code: A 1971 Perspective", see 48 Den. L.J. 27 (1971).

5-5-102. Scope. This part 1 applies to actions or other proceedings to enforce rights arising from consumer credit transactions.

Source: L. 2000: Entire article R&RE, p. 1233, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-102, as it existed prior to 2000.

5-5-103. Restrictions on deficiency judgments in consumer credit sales. (1) This section applies to a consumer credit sale of goods or services. A consumer is not liable for a deficiency unless the creditor has disposed of the goods in accordance with the provisions on the disposition of collateral of the "Uniform Commercial Code" contained in part 6 of

article 9 of title 4, C.R.S.

(2) If the creditor repossesses, with or without the aid of judicial process, or voluntarily accepts surrender of goods that were the subject of the sale and in which the creditor has a security interest, the parties obligated are not personally liable to the creditor for the unpaid balance of the debt arising from the sale of a commercial unit of goods of which the cash sale price was three thousand dollars or less, and the creditor's duty to dispose of the collateral is governed by the provisions on the disposition of collateral of the "Uniform Commercial Code" contained in part 6 of article 9 of title 4, C.R.S.

(3) If the creditor repossesses, with or without the aid of judicial process, or voluntarily accepts surrender of goods that were not the subject of the sale but in which the creditor has a security interest to secure a debt arising from a sale of goods or services or a combined sale of goods and services and the cash price of the sale was three thousand dollars or less, the parties obligated are not personally liable to the creditor for the unpaid balance of the debt arising from the sale, and the creditor's duty to dispose of the collateral is governed by the provisions on disposition of collateral of the "Uniform Commercial Code" contained in part 6 of article 9 of title 4, C.R.S.

(4) For the purpose of determining the unpaid balance of consolidated debts or debts pursuant to revolving credit accounts, the allocation of payments to a debt shall be determined in the same manner as provided for determining the amount of debts secured by various security interests under sections 5-3-202 and 5-3-203.

(5) The consumer may be liable in damages to the creditor if the consumer has misused, abused, or wrongfully damaged the collateral or if, after default and demand in writing, the consumer has wrongfully failed to make the collateral available to the creditor. Nothing in this section shall limit or restrict the remedies of the holders of a security interest for damage to the collateral because of conversion, destruction, or other wrongful acts.

(6) If the creditor elects to bring an action against the consumer for a debt arising from a consumer credit sale of goods or services, when under this section the creditor would not be entitled to a deficiency judgment if the creditor took possession of the collateral, and obtains judgment:

(a) The creditor may not take possession of the collateral; and

(b) The collateral is not subject to levy or sale on execution or similar proceedings pursuant to the judgment.

Source: L. 2000: Entire article R&RE, p. 1233, § 1, effective July 1. **L. 2001:** (1), (2), and (3) amended, p. 1444, § 36, effective July 1. **L. 2003:** (3) amended, p. 1896, § 13, effective July 1.

Editor's note: This section is similar to former § 5-5-103, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971).

5-5-104. Insecurity and impaired collateral. (1) If a creditor takes possession of any collateral because the creditor deems himself or herself insecure or because the creditor feels his or her collateral is impaired, and the creditor fails to prove that, at the time possession was taken, the creditor, in good faith, had reasonable cause to believe that he or she was insecure or that his or her collateral was impaired:

(a) The creditor shall be liable to the consumer for court costs and attorney fees as determined by the court; and

(b) The consumer shall not be liable for any finance charge incurred during the period the consumer is without use of the collateral.

Source: L. 2000: Entire article R&RE, p. 1234, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-103.5, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983).

5-5-105. No garnishment before judgment. Prior to entry of judgment in an action against the consumer for debt arising from a consumer credit transaction, the creditor may not replevin goods, except motor vehicles, of the consumer with the use of force from a dwelling upon an ex parte order of court or attach unpaid earnings of the consumer by garnishment or like proceedings.

Source: L. 2000: Entire article R&RE, p. 1234, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-104, as it existed prior to 2000.

ANNOTATION

Shares of common stock debtor purchased through an employee stock purchase plan are not exempt earnings pursuant to this section and § 13-54-104. In re Kramer, 339 P.3d 761 (Bankr. D. Colo. 2006).

5-5-106. Limitation on garnishment - definitions. (1) For the purposes of this part 1:

(a) "Disposable earnings" means that part of the earnings of an individual remaining after the deduction from those earnings of amounts required by law to be withheld.

(b) "Garnishment" means any legal or equitable procedure through which the earnings of an individual are required to be withheld for payment of a debt.

(2) (a) The maximum part of the aggregate disposable earnings of an individual for any work week that is subjected to garnishment to enforce payment of a judgment arising from a consumer credit transaction may not exceed the lesser of:

(I) Twenty-five percent of the individual's disposable earnings for that week; or

(II) The amount by which the individual's disposable earnings for that week exceed thirty times the federal minimum hourly wage prescribed by section 206 (a) (1) of the "Fair Labor Standards Act of 1938", 29 U.S.C. sec. 201 et seq., in effect at the time the earnings are payable; or

(III) The amount by which the individual's disposable earnings for that week exceed thirty times the state minimum hourly wage pursuant to section 15 of article XVIII of the state constitution in effect at the time the earnings are payable.

(b) In the case of earnings for a pay period other than a week, the administrator may prescribe by rule a multiple of the federal minimum hourly wage or the state minimum hourly wage, equivalent in effect to that set forth in subparagraphs (II) or (III) of paragraph (a) of this subsection (2).

(3) No court may make, execute, or enforce an order or process in violation of this section.

(4) It shall not be necessary for any individual to claim the exemptions for that portion of the aggregate disposable earnings that are not subject to garnishment as set forth in subsection (2) of this section, and such exemption from garnishment shall be self-executing in any garnishment procedure.

(5) This section does not repeal, alter, or affect other statutes of this state prohibiting garnishments or providing for larger exemptions from garnishments than are allowed under this section.

Source: L. 2000: Entire article R&RE, p. 1234, § 1, effective July 1. **L. 2007:** (2) amended, p. 878, § 6, effective July 1.

Editor's note: This section is similar to former § 5-5-105, as it existed prior to 2000.

Cross references: For the legislative declaration contained in the 2007 act amending subsection (2), see section 1 of chapter 226, Session Laws of Colorado 2007.

ANNOTATION

Annotator's note. Since § 5-5-106 is similar to § 5-5-105 as it existed prior to the 2000 repeal and reenactment of articles 1 to 3 and 4 to 6 of this title, relevant cases construing that provision have been included in the annotations to this section.

This section is substantially similar to the federal wage garnishment law. First Nat'l Bank v. Columbia Credit Corp., 179 Colo. 242, 499 P.2d 1163 (1972).

Consequently, garnishments may be exempted from federal act. The secretary of labor may exempt from the garnishment provisions of the federal act garnishments under the law of any state which are substantially similar to those provided in the federal wage garnishment law. First Nat'l Bank v. Columbia Credit Corp., 179 Colo. 242, 499 P.2d 1163 (1972).

The federal wage garnishment law does not annul, alter, affect, or exempt any person from complying with state laws which prohibit garnishment, or which provide for more limited garnishments than are permitted under federal law. First Nat'l Bank v. Columbia Credit Corp., 179 Colo. 242, 499 P.2d 1163 (1972).

Whichever law is the more restrictive and results in the smaller garnishment is the one which must be applied in any given situation. First Nat'l Bank v. Columbia Credit Corp., 179 Colo. 242, 499 P.2d 1163 (1972).

Limitation inapplicable to child support obligations. The limitation contained in subsection (2) is inapplicable to an order of assignment of wages to enforce child support obligations. In re McCue, 645 P.2d 854 (Colo. App. 1982).

Applied in Bernstein v. Richardson, 34 Bankr. 611 (Bankr. D. Colo. 1983).

5-5-107. No discharge from employment for garnishment. No employer shall discharge an employee for the reason that a creditor of the employee has subjected or attempted to subject unpaid earnings of the employee to garnishment or like proceedings directed to the employer for the purpose of paying a judgment arising from a consumer credit transaction.

Source: L. 2000: Entire article R&RE, p. 1235, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-106, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Punitive Damages in Wrongful Discharge Cases", see 15 Colo. Law. 658 (1986).

5-5-108. Extortionate extensions of credit. (1) If it is the understanding of the creditor and the consumer at the time an extension of credit is made that delay in making repayment or failure to make repayment could result in the use of violence or other criminal means to cause harm to the person, reputation, or property of any person, the repayment of the extension of credit is unenforceable through civil judicial processes against the consumer.

(2) If it is shown that an extension of credit was made at an annual percentage rate exceeding forty-five percent calculated according to the actuarial method and that the creditor then had a reputation for the use or threat of use of violence or other criminal means to cause harm to the person, reputation, or property of any person to collect extensions of credit or to punish the nonpayment thereof, there is prima facie evidence that the extension of credit was unenforceable under subsection (1) of this section.

Source: L. 2000: Entire article R&RE, p. 1235, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-107, as it existed prior to 2000.

5-5-109. Unconscionability - inducement by unconscionable conduct - unconscionable debt collection. (1) With respect to a transaction that is, gives rise to, or leads the consumer to believe will give rise to a consumer credit transaction, if the court as a matter of law finds:

(a) The agreement or transaction to have been unconscionable at the time it was made, or to have been induced by unconscionable conduct, the court may refuse to enforce the agreement; or

(b) Any term or part of the agreement or transaction to have been unconscionable at the time it was made, the court may refuse to enforce the agreement, enforce the remainder of the agreement without the unconscionable term or part, or so limit the application of any unconscionable term or part as to avoid any unconscionable result.

(2) With respect to a consumer credit transaction, if the court as a matter of law finds that a person has engaged in, is engaging in, or is likely to engage in unconscionable conduct in collecting a debt arising from that transaction, the court may grant an injunction and award the consumer any actual damages the consumer has sustained.

(3) If it is claimed or appears to the court that the agreement or transaction or any term or part thereof may be unconscionable or that a person has engaged in, is engaging in, or is likely to engage in unconscionable conduct in collecting a debt, the parties shall be afforded a reasonable opportunity to present evidence as to the setting, purpose, and effect of the agreement or transaction or term or part thereof or of the conduct to aid the court in making the determination.

(4) In applying subsection (2) of this section, consideration shall be given to each of the following factors, among others, as applicable:

(a) Using or threatening to use force or violence against the consumer or members of the consumer's family;

(b) Communicating with the consumer or a member of the consumer's family at frequent intervals or at unusual hours or under other circumstances so that it is a reasonable inference that the primary purpose of the communication was to harass the consumer;

(c) Using fraudulent, deceptive, or misleading representations such as a communication that simulates legal process or that gives the appearance of being authorized, issued, or approved by a government, governmental agency, or attorney at law when it is not or threatening or attempting to enforce a right with knowledge or reason to know that the right does not exist;

(d) Causing or threatening to cause injury to the consumer's reputation or economic status by:

(I) Disclosing information affecting the consumer's reputation for credit worthiness with knowledge or reason to know that the information is false;

(II) Communicating with the consumer's employer before obtaining a final judgment against the debtor, except, as permitted by statute, to verify the consumer's employment, to ascertain the consumer's whereabouts, or to request that the consumer contact the creditor;

(III) Disclosing to a person, with knowledge or reason to know that the person does not have a legitimate business need for the information, or in any way prohibited by statute, information affecting the consumer's credit or other reputation; or

(IV) Disclosing information concerning the existence of a debt known to be disputed by the consumer without disclosing that fact;

(e) Engaging in conduct with knowledge that like conduct has been restrained or enjoined by a court in a civil action by the administrator against any person pursuant to the provisions on injunctions against fraudulent or unconscionable agreements or conduct contained in section 5-6-112.

(5) If, in an action in which unconscionability is claimed, the court finds unconscionability pursuant to subsection (1) or (2) of this section, the court may award reasonable fees to the attorney for the consumer. If the court does not find unconscionability and the consumer claiming unconscionability has brought or maintained an action the consumer knew to be groundless, the court may award reasonable fees to the attorney for the party against whom the claim is made. In determining attorney fees, the amount of the recovery on behalf of the consumer is not controlling.

(6) The remedies of this section are in addition to remedies otherwise available for the same conduct under laws other than this code, but double recovery of actual damages may not be had.

(7) For the purpose of this section, a charge or practice expressly permitted by this code is not in itself unconscionable.

Source: L. 2000: Entire article R&RE, p. 1236, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-108, as it existed prior to 2000.

Cross references: For the "Colorado Fair Debt Collection Practices Act", see article 14 of title 12.

ANNOTATION

Law reviews. For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983). For article, "Default Judgments Against Consumers: Has the System Failed?", see 67 Den. U. L. Rev. 357 (1990).

Annotator's note. Since § 5-5-109 is similar to § 5-5-108 as it existed prior to the 2000 repeal and reenactment of articles 1 to 3 and 4 to 6 of this title, relevant cases construing that provision have been included in the annotations to this section.

Section 1681 h(e) of the Fair Credit Reporting Act does not furnish defendant immunity from a statutory claim under this section since nothing in this section is inconsistent with the regulatory provisions of the Act and since an action under this section is to enforce a statutory right, and is not an action in the nature of defamation or invasion of privacy. Conley v. Greenwood Trust Co., 923 P.2d 307 (Colo. App. 1996), aff'd in part and rev'd in part on other grounds, 938 P.2d 1141 (Colo. 1997).

Liability under this section is not dependent upon proof demonstrating that the plaintiff was legally indebted to defendant. Once the purported creditor treats another party as a debtor, that party will be recognized as such for purposes of this section. Conley v. Greenwood Trust Co., 923 P.2d 307 (Colo. App. 1996).

This section applies to consumer credit, lease, or loan transactions and does not apply to a loan made by a person who was not in the business of making loans; therefore, even though 50% interest rate on note was usurious, realtor who made loan was entitled to maximum legal rate of 45% interest on note. Brown v. Fenner, 757 P.2d 184 (Colo. App. 1988).

5-5-110. Notice of right to cure. (1) With respect to a consumer credit transaction, after a consumer has been in default for ten days for failure to make a required payment and has not voluntarily surrendered possession of goods or the mobile home that are collateral, a creditor may give the consumer the notice described in this section. A creditor gives notice to the consumer pursuant to this section when the creditor delivers the notice to the consumer or mails the notice to the consumer at the consumer's residence, as defined in section 5-1-201 (6).

(2) Except as provided in subsection (3) of this section, the notice shall be in writing and conspicuously state: The name, address, and telephone number of the creditor to which payment is to be made, a brief identification of the credit transaction, the right to cure the default, and the amount of payment and date by which payment must be made to cure the default. A notice in substantially the following form complies with this subsection (2):

(Name, address, and telephone number of creditor)

(Account number, if any)

(Brief identification of credit transaction)

(Date) is the LAST DATE FOR PAYMENT.

(Amount) is the AMOUNT NOW DUE.

You are late in making your payment(s). If you pay the AMOUNT NOW DUE (above) by the LAST DAY FOR PAYMENT (above), you may continue with the

contract as though you were not late. If you do not pay by this date, we may exercise our rights under the law.

If you are late again in making your payments, we may exercise our rights without sending you another notice like this one. If you have questions, write or telephone the creditor promptly.

(3) If the consumer credit transaction is a consumer insurance premium loan, the notice shall conform to the requirements of subsection (2) of this section, and a notice in substantially the form specified in subsection (2) of this section shall be deemed compliance with this subsection (3) except for the following:

(a) In lieu of a brief identification of the credit transaction, the notice shall identify the transaction as a consumer insurance premium loan and shall identify each policy or contract that may be canceled;

(b) In lieu of the statement in the form of notice specified in subsection (2) of this section that the creditor may exercise its rights under law, a statement shall be included that each policy or contract identified in the notice may be canceled; and

(c) The last paragraph of the form of notice specified in subsection (2) of this section shall be omitted.

(4) A notice of right to cure delivered or mailed to a cosigner pursuant to this section shall be modified to state that the consumer is late in making his or her payment, include the consumer's name, and that if the amount now due is not paid by the last date for payment, the creditor may exercise its rights against the consumer, cosigner, or both.

Source: L. 2000: Entire article R&RE, p. 1237, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 5-5-111, as it existed prior to 2000.

(2) Although this section was effective on July 1, 2000, section 5 of chapter 265, Session Laws of Colorado 2000, provides that the disclosures described in subsection (4) are effective January 1, 2001.

ANNOTATION

Law reviews. For article, "Mechanic's Liens — The 'Intent' Provisions Explored", see 11 Colo. Law. 1492 (1982). For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983). For article, "Setoff and Security Interests In Deposit Accounts", see 17 Colo. Law. 2108 (1988). For article, "Default Judgments Against Consumers: Has the System Failed?", see 67 Den. U. L. Rev. 357 (1990).

Annotator's note. Since § 5-5-110 is similar to § 5-5-111 as it existed prior to the 2000 repeal and reenactment of articles 1 to 3 and 4 to 6 of this title, relevant cases construing that provision have been included in the annotations to this section.

Buyer may also be entitled to redeem. In addition to the right to cure, as provided by this section and § 5-5-112, a buyer may be entitled to redeem, but only if the trial court determines that the equities so warrant. Woods v. Monticello Dev. Co., 656 P.2d 1324 (Colo. App. 1982).

Creditor choosing not to effect actual delivery must use method of mail likely to insure that the notice is actually delivered to the debtors' residence. Aetna Fin. Co. v. Summers, 44 Colo. App. 491, 618 P.2d 726 (1980), aff'd, 642 P.2d 926 (Colo. 1982).

Mailing by certified mail return receipt requested does not per se constitute notice to the debtor under subsection (1). Aetna Fin. Co. v. Summers, 44 Colo. App. 491, 618 P.2d 726 (1980), aff'd, 642 P.2d 926 (Colo. 1982).

Statutory notice method required when debtor had knowledge alternate method failed. Once the creditor has actual knowledge that the debtor has not received a notice mailed by certified mail, return receipt requested, it was incumbent upon creditor to satisfy the statutory notice requirement by personal service or by sending the notice by regular mail to debtor's home. Aetna Fin. Co. v. Summers, 642 P.2d 926 (Colo. 1982).

5-5-111. Cure of default. (1) With respect to a consumer credit transaction, except as provided in subsection (2) of this section, after a default consisting only of the consumer's failure to make a required payment, a creditor, because of that default, may neither

accelerate maturity of the unpaid balance of the obligation nor take possession of or otherwise enforce a security interest in the goods or the mobile home that are collateral until twenty days after giving the consumer a notice of right to cure described in section 5-5-110. Until the expiration of the minimum applicable period after the notice is given, all defaults consisting of a failure to make the required payment may be cured by tendering to the creditor the amount of all unpaid sums due at the time of the tender, without acceleration, plus any unpaid delinquency or deferral charges. Cure restores the consumer to his or her rights under the agreement as though the defaults had not occurred.

(2) With respect to defaults on the same obligation, other than defaults on an obligation secured by a mobile home, after a creditor has once given the consumer a notice of right to cure described in section 5-5-110, this section gives no right to cure and imposes no limitation on the creditor's right to proceed against the consumer or goods that are collateral with respect to any subsequent default that occurs within twelve months of such notice. With respect to defaults on the same obligation that is secured by a mobile home, this section gives no right to cure and imposes no limitation on the creditor's right to proceed against the consumer or goods that are collateral with respect to any third default that occurs within twelve months of such notice. For the purpose of this section, in connection with revolving credit accounts, the obligation is the consumer's account, and there is no right to cure and no limitation on the creditor's rights with respect to any default that occurs within twelve months after an earlier default as to which a creditor has given the consumer notice of right to cure.

(3) Unless a creditor has provided the cosignor on a consumer credit transaction with a notice of right to cure that complies with section 5-5-110 and this section, in addition to the notice of right to cure provided to the consumer, the creditor may neither accelerate maturity of the unpaid balance of the obligation as to the cosignor nor report that amount on the cosignor's consumer report with a consumer reporting agency as defined in section 12-14.3-102, C.R.S., and 15 U.S.C. sec. 1681a.

(4) This section and the provisions on waiver, agreements to forego rights, and settlement of claims do not prohibit a consumer from voluntarily surrendering possession of goods that are collateral and the creditor from thereafter enforcing its security interest in the goods at any time after default.

(5) This section shall not apply to consumer credit transactions that are payable in four or fewer installments.

Source: L. 2000: Entire article R&RE, p. 1239, § 1, effective July 1.

Editor's note: (1) This section is similar to former § 5-5-112, as it existed prior to 2000.

(2) Although this section was effective on July 1, 2000, section 5 of chapter 265, Session Laws of Colorado 2000, provides that the disclosures described in subsection (3) are effective January 1, 2001.

ANNOTATION

Law reviews. For article, "Secured Transactions — Part II: Default, Foreclosure and Bankruptcy", see 12 Colo. Law. 13 (1983).

Annotator's note. Since § 5-5-111 is similar to § 5-5-112 as it existed prior to the 2000 repeal and reenactment of articles 1 to 3 and 4 to 6 of this title, relevant cases construing that provision have been included in the annotations to this section.

Buyer may also be entitled to redeem. In addition to the right to cure, as provided by this section and § 5-5-111, a buyer may be entitled to redeem, but only if the trial court determines that the equities so warrant. Woods v. Monticello Dev. Co., 656 P.2d 1324 (Colo. App. 1982).

Penalty for violation. An appropriate penalty for the violation of this section is the penalty imposed by § 4-9-507 (1). D.E.B. Adjustment Co. v. Cawthorne, 623 P.2d 82 (Colo. App. 1981).

A lender must strictly comply with notice provisions of the UCCC before it can accelerate a loan and repossess collateral. This section permits acceleration only after a notice of a debtor's right to cure is given. Accelerating a loan prior to the giving of notice as required by this section is improper. First Nat. Bank v. Union Tavern Corp., 794 P.2d 261 (Colo. App. 1990).

This section prohibits a lender from charging default interest against a debtor prior to

giving notice of default as required by this section. First Nat. Bank v. Union Tavern Corp., 794 P.2d 261 (Colo. App. 1990).

This section and next section preclude a creditor under a consumer credit transaction from pursuing a replevin remedy prior to the expiration of the 20-day notice period set forth in this section. Green Tree Fin. v. Short, 10 P.3d 721 (Colo. App. 2000).

Applied in Aetna Fin. Co. v. Summers, 642 P.2d 926 (Colo. 1982).

5-5-112. Attorney fees. (1) With respect to a consumer credit transaction, the agreement may provide for the payment by the consumer of reasonable attorney fees not in excess of fifteen percent of the unpaid debt after default and referral to an attorney not a salaried employee of the creditor or such additional fee as may be directed by the court. A provision in violation of this section is unenforceable.

(2) This section does not authorize the imposition of attorney fees for preparation of a notice of right to cure if the consumer cures the default pursuant to sections 5-5-110 and 5-5-111.

Source: L. 2000: Entire article R&RE, p. 1240, § 1, effective July 1.

Editor's note: This section is similar to former §§ 5-2-413, 5-3-404, and 5-3-514, as they existed prior to 2000.

ANNOTATION

Law reviews. For article, "State Variations of the Uniform Consumer Credit Code: The Case for Legislative Restraint", see 48 Den. L.J. 239 (1971).

Where litigation involved an installment sale contract entered into prior to October 1, 1971, this section did not apply. John Deere Co. v. Catalano, 186 Colo. 101, 525 P.2d 1153 (1974) (decided under law in effect prior to the 2000 repeal and reenactment).

Applied in Nat'l City Bank of Denver v. Sather, 677 P.2d 432 (Colo. App. 1983) (decided under law in effect prior to the 2000 repeal and reenactment).

PART 2

CONSUMERS' REMEDIES

5-5-201. Effect of violations on rights of parties. (1) If a creditor has violated the provisions of this code applying to limitations on the schedule of payments or loan term for supervised loans contained in section 5-2-308 or authority to make supervised loans contained in section 5-2-301, the consumer is not obligated to pay the finance charge and has a right to recover from the person violating this code or from an assignee of that person's rights who undertakes direct collection of payments or enforcement of rights arising from the debt a penalty in an amount determined by the court not in excess of three times the amount of the finance charge. With respect to violations arising from consumer credit transactions made pursuant to revolving credit accounts, no action pursuant to this subsection (1) may be brought more than two years after the violation occurred. With respect to violations arising from other consumer credit transactions, no action pursuant to this subsection (1) may be brought more than one year after the due date of the last scheduled payment of the agreement with respect to which the violation occurred.

(2) A consumer is not obligated to pay a charge in excess of that allowed by this code, and if a consumer has paid an excess charge he or she has a right to a refund. A refund may be made by reducing the consumer's obligation by the amount of the excess charge. If the consumer has paid an amount in excess of the lawful obligation under the agreement, the consumer may recover the excess amount from the person who made the excess charge or from an assignee of that person's rights who undertakes direct collection of payments from or enforcement of rights against consumers arising from the debt.

(3) If a consumer is entitled to a refund and a person liable to the consumer refuses to make a refund within a reasonable time after demand, the consumer may recover from that

person a penalty in an amount determined by a court not exceeding the greater of either the amount of the finance charge or ten times the amount of the excess charge. If the creditor has made an excess charge in deliberate violation of or in reckless disregard for this code, the penalty may be recovered even though the creditor has refunded the excess charge. No penalty pursuant to this subsection (3) may be recovered if a court has ordered a similar penalty assessed against the same person in a civil action by the administrator described in section 5-6-114. With respect to excess charges arising from revolving credit accounts, no action pursuant to this subsection (3) may be brought more than two years after the time the excess charge was made. With respect to excess charges arising from other consumer credit transactions, no action pursuant to this subsection (3) may be brought more than one year after the due date of the last scheduled payment of the agreement pursuant to which the charge was made.

(4) Except as otherwise provided, no violation of this code impairs rights on a debt.

(5) If an employer discharges an employee in violation of the provisions prohibiting discharge contained in section 5-5-107, the employee may within ninety days bring a civil action for recovery of wages lost as a result of the violation and for an order requiring the reinstatement of the employee. Damages recoverable shall not exceed lost wages for six weeks.

(6) If the creditor establishes by a preponderance of evidence that a violation is unintentional or the result of a bona fide error, notwithstanding the maintenance of procedures reasonably adopted to avoid the error, no liability is imposed under subsections (1) and (3) of this section, and the validity of the transaction is not affected.

(7) In any case in which it is found that a creditor has violated this code, the court may award reasonable attorney fees incurred by the consumer.

(8) If a creditor repeatedly fails to provide a consumer with a statement of an annual percentage rate or finance charge as and to the extent required by the provisions on disclosure contained in section 5-3-101 of this code and has received written notice from the administrator of such repeated failure, any such subsequent failure by the creditor shall relieve any consumer receiving such defective disclosure from any obligation to pay any finance charge in connection with such consumer credit transaction.

Source: L. 2000: Entire article R&RE, p. 1240, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-202, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982).

Annotator's note. Since § 5-5-201 is similar to § 5-5-202 as it existed prior to the 2000 repeal and reenactment of articles 1 to 3 and 4 to 6 of this title, relevant cases construing that provision have been included in the annotations to this section.

Section 5-5-204(2) is interpreted to be as "otherwise provided" under subsection (5) of this section, which states that "except as otherwise provided, no violation of this code impairs rights on a debt". Strader v. Beneficial Fin. Co., 191 Colo. 206, 551 P.2d 720 (1976).

Section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 preempted plaintiff's claims against a Delaware bank that the bank's late charges violated this section and § 5-5-203. Stoorman v. Greenwood Trust Co., 888 P.2d 289 (Colo. App. 1994).

"Interest" under § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 includes late fees and, therefore, Colorado law is preempted by the federal law with respect to late charges. Stoorman v. Greenwood Trust Co., 888 P.2d 289 (Colo. App. 1994).

Plaintiff's common law challenges were preempted by § 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 since that law creates an exclusive federal remedy and an exclusive federal remedy is inconsistent with the idea that a plaintiff can seek relief under state common law theories. Stoorman v. Greenwood Trust Co., 888 P.2d 289 (Colo. App. 1994).

Applied in Greeley Nat. Bank v. Sloan, 677 P.2d 409 (Colo. App. 1983).

5-5-202. Civil liability for violation of disclosure provisions. (1) Except as otherwise provided in this section, a creditor who, in violation of the provisions on disclosure contained in section 5-3-101, other than the provisions on advertising, fails to disclose information to a person entitled to the information under this code is liable to that person in an amount equal to the sum of:

(a) Twice the amount of the finance charge in connection with the transaction, but the liability pursuant to this paragraph (a) shall be not less than one hundred dollars nor more than one thousand dollars; and

(b) In the case of a successful action to enforce the liability under paragraph (a) of this subsection (1), the costs of the action together with reasonable attorney fees as determined by the court.

(2) A creditor has no liability under this section if, within sixty days after discovering an error and prior to the institution of an action under this section or the receipt of written notice of the error, the creditor notifies the person concerned of the error and makes whatever adjustments in the appropriate account are necessary to assure that the person will not be required to pay a finance charge in excess of the amount or percentage rate actually disclosed.

(3) A creditor may not be held liable in any action brought under this section for a violation of this code if the creditor shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid the error.

(4) Any action that may be brought under this section against the original creditor in any credit transaction involving a security interest in land may be maintained against any subsequent assignee of the original creditor where the assignee, its subsidiaries, or affiliates were in a continuing business relationship with the original creditor either at the time the credit was extended or at the time of the assignment unless the assignment was involuntary or the assignee shows by a preponderance of evidence that it did not have reasonable grounds to believe that the original creditor was engaged in violations of this code and that it maintained procedures reasonably adapted to apprise it of the existence of the violations.

(5) No action pursuant to this section may be brought more than one year after the date of the occurrence of the violation.

(6) In this section, creditor includes a person who in the ordinary course of business regularly extends or arranges for the extension of credit or offers to arrange for the extension of credit.

(7) No provision of this section or section 5-5-201 imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule, regulation, interpretation, or written response to a person pursuant to a written request on behalf of such identified person by the administrator or the board of governors of the federal reserve system pursuant to the federal "Truth in Lending Act" or federal "Consumer Leasing Act", notwithstanding that, after such act or omission has occurred, such rule, regulation, interpretation, or written response is amended, rescinded, or determined by judicial or other authority to be invalid for any reason.

(8) The multiple failure to disclose to any person any information required under this code to be disclosed in connection with a single account under a revolving credit account, other single consumer credit sale, consumer loan, or other extension of consumer credit shall entitle the person to a single recovery under this section, but continued failure to disclose after recovery has been granted shall give rise to rights to additional recoveries.

Source: L. 2000: Entire article R&RE, p. 1241, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-203, as it existed prior to 2000.

Cross references: For the definitions and federal statutory cites of the "Truth in Lending Act" and the "Consumer Leasing Act", see § 5-1-302.

ANNOTATION

Annotator's note. Since § 5-5-202 is similar to § 5-5-203 as it existed prior to the 2000 repeal and reenactment of articles 1 to 3 and 4 to 6 of this title, relevant cases construing that provision have been included in the annotations to this section.

This section specifically authorized the award of reasonable attorney's fees "as determined by the court". Rachbach v. Cogswell, 547 F.2d 502 (10th Cir. 1976).

In an action under the Truth in Lending Act (15 U.S.C. § 1601 et seq.), even if the Colorado law were applicable to the issue of attorney's fees, where the record contained no showing of what were reasonable fees, the federal circuit court could not determine whether the trial court abused its discretion in denying those fees. Rachbach v. Cogswell, 547 F.2d 502 (10th Cir. 1976).

Borrowers not barred in demand for attorneys' fees. Where, by its continued breach of its duty, even after being ordered to take corrective action by the Colorado uniform consumer credit code administration, a lender delayed the borrowers' knowledge of the true 19.07 percent interest rate on the loan for a period of five and one-half months, to permit the lender to raise the statute of limitations to bar the borrowers would be unjust, and, therefore, the borrowers were not barred by the statute of limitations in their demand for attorneys' fees. Strader v. Beneficial Fin. Co., 191 Colo. 206, 551 P.2d 720 (1976).

Applied in Hull v. Bowest Corp., 649 P.2d 334 (Colo. App. 1982).

5-5-203. Consumer's right to rescind certain transactions. In the case of a consumer credit transaction with respect to which a security interest is retained or acquired in any property that is used as the principal dwelling of the person to whom credit is extended, the consumer shall have the same right to rescind the transaction as provided in the federal "Truth in Lending Act" and regulations thereunder. In order to comply with this code, a creditor shall comply with those provisions on the right of rescission of certain transactions.

Source: L. 2000: Entire article R&RE, p. 1243, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-204, as it existed prior to 2000.

Cross references: For the definition and federal statutory cite of the "Truth in Lending Act", see § 5-1-302.

ANNOTATION

Law reviews. For case note, "Consequences of the Creditor's Failure to Acknowledge Rescission by the Debtor Under Strader v. Beneficial Fin. Co.", see 48 U. Colo. L. Rev. 437 (1977). For article, "An Overview of Home Equity as Security for a Line of Credit", see 14 Colo. Law. 226 (1985).

Annotator's note. Since § 5-5-203 is similar to § 5-5-204 as it existed prior to the 2000 repeal and reenactment of articles 1 to 3 and 4 to 6 of this title, relevant cases construing that provision have been included in the annotations to this section.

This section expressly applies to consumer credit sales and consumer loans. Strader v. Beneficial Fin. Co., 191 Colo. 206, 551 P.2d 720 (1976).

The consumer borrower and the consumer buyer are to be treated the same under this section. Strader v. Beneficial Fin. Co., 191 Colo. 206, 551 P.2d 720 (1976).

Subsection (2) is interpreted to be as "otherwise provided" under § 5-5-202(5), which states that "except as otherwise provided, no violation of this code impairs rights on a debt". Strader v. Beneficial Fin. Co., 191 Colo. 206, 551 P.2d 720 (1976).

The requirement of tender arises only after the security interest is released. Strader v. Beneficial Fin. Co., 191 Colo. 206, 551 P.2d 720 (1976).

The creditor is specifically obligated to take any action necessary or appropriate to reflect the termination of the security interest within 10 days after receipt of the notice of rescission and no duty is imposed upon the debtor until after the performance of the creditor's obligations. Strader v. Beneficial Fin. Co., 191 Colo. 206, 551 P.2d 720 (1976).

When debtor relieved of obligation to tender. If the security interest is not released within the 10 days following notice of rescission, the debtor is relieved of the obligation to tender and the property vests in the debtor. Strader v. Beneficial Fin. Co., 191 Colo. 206, 551 P.2d 720 (1976).

Effect of failure to take possession of property tendered. After tender by the debtor, if the creditor fails to take possession of the property tendered, "ownership of the property vests in

the debtor without obligation to pay . . . ". This statutory provision is intended as an impetus for the creditor to take immediate action to clear title and to fulfill its obligations. Strader v. Beneficial Fin. Co., 191 Colo. 206, 551 P.2d 720 (1976).

Applied in Griffin v. United Bank, 40 Colo. App. 513, 580 P.2d 818 (1978); Griffin v. United Bank, 198 Colo. 239, 599 P.2d 866 (1979); Varady v. White, 42 Colo. App. 389, 595 P.2d 272 (1979); Varady v. White, 661 P.2d 284 (Colo. App. 1982); Campbell v. Commercial Credit Plan, Inc., 670 P.2d 813 (Colo. App. 1983).

5-5-204. Interests in land. For purposes of the provisions on civil liability for violation of the disclosure provisions contained in section 5-5-202 and on a consumer's right to rescind certain transactions contained in section 5-5-203, "consumer credit transaction" includes a transaction primarily secured by an interest in land without regard to the rate of the finance charge if the transaction is otherwise a consumer credit transaction.

Source: L. 2000: Entire article R&RE, p. 1243, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-201, as it existed prior to 2000.

5-5-205. Refunds and penalties as set-off to obligation. Refunds or penalties to which the consumer is entitled pursuant to this part 2 may be set off against the consumer obligation and may be raised as a defense to a suit on the obligation without regard to the time limitations prescribed by said sections.

Source: L. 2000: Entire article R&RE, p. 1243, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-205, as it existed prior to 2000.

5-5-206. Civil liability for discrimination. If a person has failed to comply with section 5-3-210, the person aggrieved by such failure to comply has a right to recover actual damages from such person but in no event less than one hundred dollars for actual and exemplary damages nor more than one thousand dollars for actual and exemplary damages. In the case of a successful action to enforce such right of recovery, the aggrieved person shall recover the costs of the action together with reasonable attorney fees as determined by the court.

Source: L. 2000: Entire article R&RE, p. 1243, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-206, as it existed prior to 2000.

Cross references: For discrimination, see article 34 of title 24.

PART 3

CRIMINAL PENALTIES

5-5-301. Willful violations. (1) A supervised lender who willfully makes charges in excess of those permitted by the provisions of this code is guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine of not more than five thousand dollars, or by imprisonment in the county jail for not more than one year, or by both such fine and imprisonment.

(2) A person, other than a supervised financial organization, who willfully engages in the business of making supervised loans without a license in violation of the provisions of this code applying to the authority to make supervised loans described in section 5-2-301 is guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine of not more than five thousand dollars, or by imprisonment in the county jail for not more than one year, or by both such fine and imprisonment.

(3) A person who willfully engages in the business of making consumer credit transactions or of taking assignments of rights against consumers arising therefrom and undertakes direct collection of payments or enforcement of these rights without complying with the provisions of this code concerning notification contained in section 5-6-202 or payment of fees contained in section 5-6-203 is guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine of not more than one thousand dollars.

(4) Any person who violates the provisions of this section and by the same act or acts violates the provisions of section 18-15-104 or 18-15-107, C.R.S., or both, shall be prosecuted for the violation of either or both of said sections and not for a violation of this section.

Source: L. 2000: Entire article R&RE, p. 1243, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-301, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Criminal Prosecutions under the Colorado Securities Act", see 47 U. Colo. L. Rev. 233 (1976).

5-5-302. Disclosure violations. (1) A person is guilty of a misdemeanor, and upon conviction thereof, shall be punished by a fine of not more than five thousand dollars, or by imprisonment in the county jail for not more than one year, or by both such fine and imprisonment if such person willfully and knowingly:

(a) Gives false or inaccurate information or fails to provide information that such person is required to disclose under the provisions of this code on disclosure and advertising or of any related rule of the administrator adopted pursuant to this code;

(b) Uses any rate table or chart in a manner which consistently understates the annual percentage rate determined according to those provisions; or

(c) Otherwise fails to comply with any requirement of the provisions of this code on disclosure and advertising or of any related rule of the administrator adopted pursuant to this code.

Source: L. 2000: Entire article R&RE, p. 1244, § 1, effective July 1.

Editor's note: This section is similar to former § 5-5-302, as it existed prior to 2000.

ARTICLE 6

Administration

Editor's note: This article was numbered as article 6 of chapter 73, C.R.S. 1963. This title was repealed and reenacted in 1971, and this article was subsequently repealed and reenacted in 2000, resulting in the addition, relocation, and elimination of sections as well as subject matter. For amendments to this article prior to 2000, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume and the editor's note following the title heading. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated. For a detailed comparison of this article, see the comparative tables located in the back of the index.

PART 1

POWERS AND FUNCTIONS OF ADMINISTRATOR

PART 2

NOTIFICATION AND FEES

PART 3

COUNCIL OF ADVISORS ON CONSUMER CREDIT

PART 1

POWERS AND FUNCTIONS OF ADMINISTRATOR

5-6-101. Short title. This article shall be known and may be cited as "Uniform Consumer Credit Code - Administration".

Source: L. 2000: Entire article R&RE, p. 1244, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-101, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Legislative Overview of the Uniform Consumer Credit Code: A 1971 Perspective", see 48 Den. L.J. 27 (1971).

5-6-102. Applicability. (1) This part 1 applies to persons who in this state:

(a) Make or solicit consumer credit transactions; or

(b) Directly collect payments from or enforce rights against consumers arising from sales, leases, or loans specified in paragraph (a) of this subsection (1) wherever they are made.

Source: L. 2000: Entire article R&RE, p. 1244, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-102, as it existed prior to 2000.

5-6-103. Definitions - "administrator". "Administrator" means the assistant attorney general to be designated by the attorney general. Any district attorney may, with the consent of the administrator, exercise the powers and perform the duties of the administrator as provided in section 5-6-104 (1) (a) and (1) (b) and sections 5-6-105 to 5-6-116.

Source: L. 2000: Entire article R&RE, p. 1245, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-103, as it existed prior to 2000.

5-6-104. Powers of administrator - harmony with federal regulations - reliance on rules. (1) In addition to other powers granted by this code, the administrator, within the limitations provided by law, may:

(a) Receive and act on complaints, take action designed to obtain voluntary compliance with this code, or commence proceedings on his or her own initiative;

(b) Counsel persons and groups on their rights and duties under this code;

(c) Establish programs for the education of consumers with respect to credit practices and problems;

(d) Make studies appropriate to effectuate the purposes and policies of this code and make the results available to the public;

(e) With approval of the council of advisors on consumer credit subcommittee, adopt, amend, and repeal substantive rules and regulations to carry out the specific provisions of this code, but not with respect to unconscionable agreements or fraudulent or unconscionable conduct, and adopt, amend, and repeal procedural rules to carry out the provisions of this code;

(f) Maintain offices within this state;

(g) Enforce the provisions of article 14.5 of title 12, C.R.S.;

(h) Employ administrative law judges from the office of administrative courts in the department of personnel to conduct hearings on any matter within the administrator's jurisdiction;

(i) License and regulate collection agencies pursuant to article 14 of title 12, C.R.S.; and

(j) Exchange information with another governmental agency or official that has regulatory authority comparable to that of the administrator, subject to an appropriate confidentiality agreement between the administrator and the other agency or official or as otherwise permitted by law. This paragraph (j) shall not be construed to allow the exchange of information with lenders or creditors.

(2) The administrator may adopt rules not inconsistent with the federal "Truth in Lending Act" and federal "Consumer Leasing Act" to assure a meaningful disclosure of credit terms so that a prospective consumer will be able to compare more readily the various credit terms available to him or her and to avoid the uninformed use of credit. Such rules shall supersede any provisions of this code that are inconsistent with the federal "Truth in Lending Act" and federal "Consumer Leasing Act", may contain classifications, differentiations, or other provisions, and may provide for adjustments and exceptions for any class of transactions subject to this code that, in the judgment of the administrator, are necessary or proper to effectuate the purposes of, or to prevent circumvention or evasion of, or to facilitate compliance with, the provisions of this code relating to disclosure of credit terms.

(3) To keep the administrator's rules in harmony with the federal "Truth in Lending Act" and the federal "Consumer Leasing Act" and the regulations prescribed from time to time pursuant to that act by the board of governors of the federal reserve system and with the rules of administrators in other jurisdictions that enact the "Uniform Consumer Credit Code", the administrator, so far as is consistent with the purposes, policies, and provisions of this code, shall:

(a) Before adopting, amending, and repealing rules and regulations, advise and consult with administrators in other jurisdictions that enact the "Uniform Consumer Credit Code"; and

(b) In adopting, amending, and repealing rules and regulations, take into consideration:

(I) The regulations so prescribed by the board of governors of the federal reserve system; and

(II) The rules of administrators in other jurisdictions that enact the "Uniform Consumer Credit Code".

(4) Except for a refund of an excess charge, no liability is imposed under this code for an act done or omitted in good faith in conformity with a rule, regulation, interpretation, or written response to a person pursuant to a written request on behalf of such identified person by the administrator, notwithstanding that after the act or omission the rule, regulation, interpretation, or written response may be amended or repealed or be determined by judicial or other authority to be invalid for any reason.

Source: L. 2000: Entire article R&RE, p. 1245, § 1, effective July 1; (1)(i) added, p. 945, § 26, effective July 1. **L. 2003:** (1)(j) added, p. 1896, § 14, effective July 1. **L. 2005:** (1)(h) amended, p. 853, § 7, effective June 1.

Editor's note: (1) This section is similar to former § 5-6-104, as it existed prior to 2000.
(2) Subsection (1)(h) from House Bill 00-1182 was harmonized with House Bill 00-1185 and renumbered as subsection (1)(i).

Cross references: For the definitions and federal statutory cites of the "Truth in Lending Act" and the "Consumer Leasing Act", see § 5-1-302.

ANNOTATION

Law reviews. For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982).

5-6-105. Administrative powers with respect to supervised financial organizations. (1) With respect to supervised financial organizations, the powers of examination and investigation described in sections 5-2-305 and 5-6-106 and administrative enforcement described in section 5-6-108 shall be exercised by the official or agency to whose supervision the organization is subject. All other powers of the administrator under this code may be exercised by the administrator with respect to a supervised financial organization.

(2) If the administrator receives a complaint or other information concerning noncompliance with this code by a supervised financial organization, the administrator shall inform the official or agency having supervisory authority over the organization concerned. The administrator may request information about supervised financial organizations from the officials or agencies supervising them.

(3) The administrator and any official or agency of this state having supervisory authority over a supervised financial organization are authorized and directed to consult and assist one another in maintaining compliance with this code. They may jointly pursue investigations, prosecute suits, and take other official action, as they deem appropriate, if either of them otherwise is empowered to take the action. The administrator may recover from a supervised financial organization the administrator's reasonable costs incurred in such investigation, suit, or other official action as part of any relief granted the administrator by a court of competent jurisdiction.

Source: L. 2000: Entire article R&RE, p. 1246, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-105, as it existed prior to 2000.

5-6-106. Investigatory powers. (1) If the administrator has reasonable cause to believe that a person has engaged in an act that is subject to action by the administrator, the administrator may make an investigation to determine if the act has been committed, and, to the extent necessary for this purpose, may administer oaths or affirmations, and, upon his or her own motion or upon request of any party, may subpoena witnesses, compel their attendance, adduce evidence, and require the production of any matter that is relevant to the investigation, including the existence, description, nature, custody, condition, and location of any books, documents, or other tangible things and the identity and location of persons having knowledge of relevant facts, or any other matter reasonably calculated to lead to the discovery of admissible evidence. In any civil action brought by the administrator as a result of such an investigation, the administrator may recover the reasonable costs of making the investigation if the administrator prevails in the action.

(2) If the person's records are located outside this state, the person at his or her option shall either make them available to the administrator at a convenient location within this state or pay the reasonable and necessary expenses for the administrator or the administrator's representative to examine them at the place where they are maintained. The administrator may designate representatives, including comparable officials of the state in which the records are located, to inspect them on the administrator's behalf.

(3) Upon failure without lawful excuse to obey a subpoena or to give testimony, the administrator may apply to the district court for an order compelling compliance.

(4) The administrator shall not make public the name or identity of a person whose acts or conduct he or she investigates pursuant to this section or the facts disclosed in the investigation, but this subsection (4) does not apply to disclosures in actions or enforcement proceedings pursuant to this code.

Source: L. 2000: Entire article R&RE, p. 1247, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-106, as it existed prior to 2000.

ANNOTATION

Absent a waiver of immunity, an Indian tribe is immune from any action—criminal, civil, or injunctive—the attorney general may bring in a court to enforce the Uniform Consumer Credit Code. State ex rel. Suthers v. Cash Ad. & Pref., 205 P.3d 389 (Colo. App. 2008), aff'd on other grounds sub nom. Cash Advance & Pref. Cash Loans v. State, 242 P.3d 1099 (Colo. 2010).

Tribal sovereign immunity does not prevent the enforcement of the attorney general's subpoenas for information relevant to the determination by the trial court of whether sovereign immunity applies to a business affiliated with the tribe. State ex rel. Suthers v. Cash Ad. & Pref., 205 P.3d 389 (Colo. App. 2008), aff'd on other grounds sub nom. Cash Advance & Pref. Cash Loans v. State, 242 P.3d 1099 (Colo. 2010).

5-6-107. Application of administrative procedures - provisions. Except as otherwise provided, the provisions of sections 24-4-102 to 24-4-106, C.R.S., apply to and govern all rules promulgated and all administrative action taken by the administrator pursuant to this article or the provisions on supervised loans contained in part 3 of article 2 of this title; except that section 24-4-104 (3), C.R.S., shall not apply to any such action.

Source: L. 2000: Entire article R&RE, p. 1247, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-107, as it existed prior to 2000.

5-6-108. Judicial review. Any person aggrieved by any final action or order of the administrator and affected thereby is entitled to a review thereof by the Colorado court of appeals by appropriate proceedings under section 24-4-106 (11), C.R.S.

Source: L. 2000: Entire article R&RE, p. 1247, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-108, as it existed prior to 2000.

5-6-109. Administrative enforcement orders. (1) After notice and hearing, the administrator may order a creditor or a person acting in the creditor's behalf to cease and desist from engaging in violations of this code or any rule or order lawfully made pursuant to this code. The order issued by the administrator may also require the creditor or person to make refunds to consumers of excess charges under this code and pay a penalty up to a maximum of one thousand dollars for each violation, all or part of which may be specifically designated for consumer and creditor educational purposes.

(2) A respondent aggrieved by an order of the administrator may obtain judicial review of the order in the Colorado court of appeals. The administrator may obtain an order of the court for enforcement of the administrator's order in the district court under section 24-4-106, C.R.S. All proceedings under this section shall be governed by sections 24-4-105 and 24-4-106, C.R.S.

(3) With respect to unconscionable agreements or fraudulent or unconscionable conduct by the respondent, the administrator may not issue an order pursuant to this section but may bring a civil action for an injunction under section 5-6-112.

Source: L. 2000: Entire article R&RE, p. 1248, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-108, as it existed prior to 2000.

5-6-110. Assurance of discontinuance. If it is claimed that a person has engaged in conduct subject to an order by the administrator described in section 5-6-108 or by a court described in sections 5-6-111 to 5-6-113, the administrator may accept an assurance in writing that the person will not engage in the conduct in the future. The assurance may also require the person to make refunds to consumers of excess charges under this code, pay a penalty up to a maximum of one thousand dollars for each violation, all or part of which may be specifically designated for consumer and creditor educational purposes, and reimburse the administrator for the administrator's reasonable costs incurred in investigating the conduct. If a person giving an assurance of discontinuance fails to comply with its terms, the assurance is evidence that prior to the assurance such person engaged in the conduct described in the assurance.

Source: L. 2000: Entire article R&RE, p. 1248, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-109, as it existed prior to 2000.

5-6-111. Injunctions against violations of code. The administrator may bring a civil action to restrain a person from violating this code or rules or regulations promulgated thereunder and for other appropriate relief.

Source: L. 2000: Entire article R&RE, p. 1248, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-110, as it existed prior to 2000.

Cross references: For injunctions, see C.R.C.P. 65.

5-6-112. Injunctions against unconscionable agreements and fraudulent or unconscionable conduct. (1) The administrator may bring a civil action to restrain a creditor or a person acting in the creditor's behalf from engaging in a course of:

(a) Making or enforcing unconscionable terms or provisions of consumer credit transactions;

(b) Fraudulent or unconscionable conduct in inducing consumers to enter into consumer credit transactions;

(c) Conduct of any of the types specified in paragraph (a) or (b) of this subsection (1) with respect to transactions that give rise to or lead persons to believe they will give rise to consumer credit transactions; or

(d) Fraudulent or unconscionable conduct in the collection of debts arising from consumer credit transactions.

(2) In an action brought pursuant to this section, the court may grant relief only if it finds:

(a) That the respondent has made unconscionable agreements or has engaged or is likely to engage in a course of fraudulent or unconscionable conduct;

(b) That the agreements or conduct of the respondent has caused or is likely to cause injury to consumers; and

(c) That the respondent has been able to cause or will be able to cause the injury primarily because the transactions involved are credit transactions.

(3) In applying this section, consideration shall be given to each of the following factors, among others:

(a) Whether the creditor should have reasonably believed at the time consumer credit transactions were made that, according to the credit terms or schedule of payments, there was no reasonable probability of payment in full of the obligation by the consumer;

(b) Whether the creditor reasonably should have known, at the time of the transaction, of the inability of the consumer to receive substantial benefits from the transaction;

(c) Gross disparity between the price of the transaction and its value measured by the price at which similar transactions are readily obtainable by like consumers;

(d) The fact that the creditor contracted for or received separate charges for insurance with respect to consumer credit transactions with the effect of making the transactions, considered as a whole, unconscionable;

(e) The fact that the respondent has knowingly taken advantage of the inability of the consumer reasonably to protect his or her interests by reason of physical or mental infirmities, ignorance, illiteracy, or inability to understand the language of the agreement, or similar factors; and

(f) Any of the factors set forth in section 5-5-109 (4).

(4) The administrator may bring a civil action to restrain a creditor or a person acting in the creditor's behalf from engaging in a course of making or arranging consumer loans to enable consumers to buy or lease from a particular seller or lessor goods or services, a principal purpose of which course of action is to avoid giving the consumers those rights that they would have had if the transactions were entered into as a consumer credit sale if:

(a) The lender is a person related to the seller or lessor unless the relationship is remote or is not a factor in the transaction;

(b) The seller or lessor guarantees the loans or otherwise assumes the risk of loss by the lender upon the loans;

(c) The loans are conditioned upon the consumer's purchase or lease of the goods or services from the particular seller or lessor, but the lender's payment of proceeds of the loan to the seller or lessor does not in itself establish that the loan was so conditioned; or

(d) The lender, before the lender makes the consumer loan, has knowledge or, from the lender's course of dealing with the particular seller or lessor or from the lender's records, notice of substantial complaints by other consumers of the particular seller's or lessor's failure or refusal to perform his or her contracts with them and of the particular seller's or lessor's failure to remedy his or her defaults within a reasonable time after notice to him or her of the complaints.

(5) In an action brought pursuant to this code, a charge or practice expressly permitted by this code is not in itself unconscionable.

Source: L. 2000: Entire article R&RE, p. 1248, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-111, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Default Judgments Against Consumers: Has the System Failed?", see 67 Den. U. L. Rev. 357 (1990).

5-6-113. Temporary relief. With respect to an action brought to enjoin violations of this code under section 5-6-111 or unconscionable agreements or fraudulent or unconscionable conduct under section 5-6-112, the administrator may apply to the court for a temporary restraining order or a preliminary injunction against a respondent pending final determination of proceedings. If the court finds after a hearing that there is reasonable cause to believe that the respondent is engaging in or is likely to engage in conduct sought to be restrained, it may grant any such temporary restraining order or preliminary injunction it deems appropriate. The court may also issue such orders or judgments as may be necessary to completely compensate or restore to his or her original position any consumer affected by such violation, agreement, or conduct or if there is reasonable cause to believe funds to make refunds of excess charges under this code will not be available at a future date. No bond or other security is required of the administrator before relief under this section may be granted.

Source: L. 2000: Entire article R&RE, p. 1250, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-112, as it existed prior to 2000.

5-6-114. Civil actions by administrator. (1) (a) The administrator may bring a civil action against a creditor for making or collecting charges in excess of those permitted by this code, violating any of the provisions of this code applying to limitations on the schedule of payments or loan term for supervised loans or authority to make supervised loans, or for disclosure violations. An action may relate to transactions with more than one consumer. If it is found that an excess charge has been made, the court shall order the respondent to refund to the consumer the amount of the excess charge and to pay a penalty to the consumer as provided in sections 5-5-201 and 5-5-202. In addition, the court may assess a civil penalty of up to one thousand dollars for each violation of this code.

(b) If a creditor has made an excess charge in deliberate violation of or in reckless disregard for this code or if a creditor has refused to refund an excess charge within a reasonable time after demand by the consumer or the administrator, the court may also order the respondent to pay to the consumers a civil penalty in an amount determined by the court not in excess of the greater of either the amount of the finance charge or ten times the amount of the excess charge. Refunds and penalties to which the consumer is entitled pursuant to this subsection (1) may be set off against the consumer's obligation.

(c) If a consumer brings an action against a creditor to recover an excess charge or civil penalty, an action by the administrator to recover for the same excess charge or civil penalty shall be stayed while the consumer's action is pending and shall be dismissed if the consumer's action is dismissed with prejudice or results in a final judgment granting or denying the consumer's claim. There shall be no double recovery for refunds of excess charges or a penalty payable to the consumer.

(d) With respect to excess charges arising from revolving accounts, no action pursuant to this subsection (1) may be brought more than four years after the time the excess charge was made. With respect to excess charges arising from other consumer credit transactions, no action pursuant to this subsection (1) may be brought more than four years after the due date of the last scheduled payment of the agreement pursuant to which the charge was made.

(e) If the creditor establishes by a preponderance of evidence that a violation is unintentional or the result of a bona fide error, no liability to pay a penalty shall be imposed under this subsection (1).

(2) The administrator may bring a civil action against a creditor or a person acting in the creditor's behalf to recover a civil penalty for willfully violating this code, and, if the court finds that the defendant has engaged in a course of repeated and willful violations of this code, it may assess a civil penalty of no more than five thousand dollars. All or part of the penalty under this subsection (2) may be specifically designated for consumer and creditor education. No civil penalty pursuant to this subsection (2) may be imposed for violations of this code occurring more than four years before the action is brought or for making unconscionable agreements or engaging in a course of fraudulent or unconscionable conduct.

(3) If the administrator prevails in an action brought under this section, the administrator may recover his or her reasonable costs in investigating and bringing the action and request an order for reimbursement of his or her reasonable attorney fees.

Source: L. 2000: Entire article R&RE, p. 1250, § 1, effective July 1. **L. 2011:** (1)(a) amended, (HB 11-1221), ch. 121, p. 381, § 3, effective July 1.

Editor's note: This section is similar to former § 5-6-113, as it existed prior to 2000.

5-6-115. Jury trial. In an action brought by the administrator under this code, the administrator has no right to trial by jury, but this will not prevent a defendant from requesting a jury trial under the Colorado rules of civil procedure.

Source: L. 2000: Entire article R&RE, p. 1252, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-114, as it existed prior to 2000.

Cross references: For jury trials, see C.R.C.P. 38.

5-6-116. Consumers' remedies not affected. The grant of powers to the administrator in this article does not affect remedies available to consumers under this code or under other principles of law or equity.

Source: L. 2000: Entire article R&RE, p. 1252, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-115, as it existed prior to 2000.

PART 2

NOTIFICATION AND FEES

5-6-201. Applicability. (1) Except as provided in subsections (2) and (3) of this section, this part 2 applies if a person:

(a) Makes consumer credit sales and charges or collects a finance charge, or makes consumer leases; or

(b) Takes assignments of and undertakes direct collection of payments from, or enforcement of rights against, consumers arising from consumer credit sales or consumer leases.

(2) This part 2 does not apply to supervised lenders described in section 5-1-301 (46), persons making consumer loans described in section 5-1-301 (15), or to persons licensed as collection agencies pursuant to article 14 of title 12, C.R.S.

(3) Sections 5-6-203 (5) and 5-6-204 of this part 2 apply to all fees collected under this code.

Source: L. 2000: Entire article R&RE, p. 1252, § 1, effective July 1. **L. 2009:** (1)(a) amended, (HB 09-1141), ch. 41, p. 158, § 4, effective January 1, 2010.

Editor's note: This section is similar to former § 5-6-201, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982).

5-6-202. Notification. (1) Persons subject to this part 2 shall file notification with, and pay the fee prescribed in section 5-6-203 to, the administrator within thirty days after commencing business in this state and, thereafter, on or before January 31 of each year. The notification shall state:

(a) Name of the person;

(b) Name in which business is transacted if different from paragraph (a) of this subsection (1);

(c) Address of principal office, which may be outside this state;

(d) Address of all offices or retail stores, if any, in this state at which consumer credit sales or consumer leases are made or, in the case of a person taking assignments of obligations, the offices or places of business within this state at which business is transacted;

(e) If consumer credit sales or consumer leases are made otherwise than at an office or retail store in this state, a brief description of the manner in which they are made;

(f) Address of designated agent upon whom service of process may be made in this state described in section 5-1-203; and

(g) Whether supervised loans are made.

(2) If information in a notification becomes inaccurate after filing, no further notification is required until the following January 31.

Source: L. 2000: Entire article R&RE, p. 1252, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-202, as it existed prior to 2000.

ANNOTATION

Law reviews. For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982).

5-6-203. Fees. (1) A person required to file notification shall, with the first notification and on or before January 31 of each year thereafter, pay to the administrator a nonrefundable annual notification fee. The administrator is entitled to examine the loans, business, and records of such person without issuance of a subpoena.

(2) (Deleted by amendment, L. 2009, (HB 09-1141), ch. 41, p. 158, § 5, effective January 1, 2010.)

(3) Persons required to file notification who are assignees of consumer credit sales or consumer leases shall pay an additional nonrefundable annual volume fee on or before January 31 of each year for each one hundred thousand dollars, or part thereof, of the unpaid balances at the time of the assignment of obligations arising from consumer credit sales or consumer leases made in this state and taken by assignment during the preceding calendar year.

(4) A penalty of five dollars per day shall be imposed on any person failing to comply with this section; except that, if the fees required by this section are paid on or before March 1 of each year, no penalty shall be imposed. If a person required to file notification and pay a notification fee fails to do so, the consumer shall have no obligation to pay the finance charge due under the consumer credit transaction, and any finance charges paid shall be refunded to the consumer. In addition, if the administrator examines the loans, business, or records of such person, the person shall pay the reasonable and necessary examination expenses of the administrator.

(5) The administrator shall determine the amount of the notification, volume, and license fees required in this section and in section 5-2-302 and may periodically reduce or increase the amount of one or more of the fees if necessary pursuant to section 24-75-402 (3) and (4), C.R.S., to reduce the uncommitted reserves of the uniform consumer credit code cash fund created in section 5-6-204 to which all or any portion of one or more of the fees is credited; except that the fund shall be subject to an alternative reserve balance of one-third of the amount expended during the previous fiscal year.

Source: L. 2000: Entire article R&RE, p. 1253, § 1, effective July 1. **L. 2009:** Entire section amended, (HB 09-1141), ch. 41, p. 158, § 5, effective January 1, 2010. **L. 2010:** (5) amended, (HB 10-1422), ch. 419, p. 2063, § 7, effective August 11.

Editor's note: This section is similar to former § 5-6-203, as it existed prior to 2000.

5-6-204. Cash fund created. (1) All fees collected under this code and under article 10 of this title shall be credited to the uniform consumer credit code cash fund, which fund is hereby created, and all moneys credited to such fund shall be used for the administration and enforcement of this code, article 10 of this title, and article 14.5 of title 12, C.R.S. Interest earned on the fund shall be credited to the fund. The general assembly shall make annual appropriations out of the fund for the administration and enforcement of this code, article 10 of this title, and article 14.5 of title 12, C.R.S.; except that expenditures by the administrator for consumer and creditor education resulting from the penalties provided in sections 5-2-303 (7) (f), 5-6-109 (1), 5-6-110, and 5-6-114 (2) shall not require appropri-

ation by the general assembly if such expenditures do not exceed twenty-five thousand dollars per fiscal year and do not include the hiring of any full-time equivalents.

(2) Notwithstanding any provision of subsection (1) of this section to the contrary, on March 27, 2002, the state treasurer shall deduct one hundred fifty thousand dollars from the uniform consumer credit code cash fund and transfer such sum to the general fund.

(3) Notwithstanding any provision of subsection (1) of this section to the contrary, on March 5, 2003, the state treasurer shall deduct one hundred thousand dollars from the uniform consumer credit code cash fund and transfer such sum to the general fund.

(4) Notwithstanding subsection (1) of this section, the state treasurer shall transfer the penalties collected pursuant to section 5-6-114 (1) (a) to the general fund.

Source: L. 2000: Entire article R&RE, p. 1254, § 1, effective July 1. **L. 2001:** Entire section amended, p. 30, § 14, effective March 9. **L. 2002:** Entire section amended, p. 150, § 1, effective March 27. **L. 2003:** (3) added, p. 454, § 1, effective March 5. **L. 2011:** (4) added, (HB 11-1221), ch. 121, p. 382, § 4, effective July 1.

Editor's note: This section is similar to former § 5-6-204, as it existed prior to 2000.

PART 3

COUNCIL OF ADVISORS ON CONSUMER CREDIT

5-6-301. Council of advisors on consumer credit. (1) There is hereby created the council of advisors on consumer credit consisting of nine members who shall be appointed by the governor. One of the advisors shall be designated by the governor as chairperson. In appointing members of the council, the governor shall seek to achieve a fair representation from the various segments of the consumer credit industry and public.

(2) The term of office of each member of the council is three years. A member chosen to fill a vacancy arising otherwise than by expiration of a term shall be appointed for the unexpired term of the member whom he or she is to succeed. A member of the council is eligible for reappointment.

(3) Members of the council shall serve without compensation but are entitled to reimbursement of actual and necessary expenses incurred in the performance of their duties.

Source: L. 2000: Entire article R&RE, p. 1254, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-301, as it existed prior to 2000.

5-6-302. Function of council - conflict of interest. (1) The council shall advise and consult with the administrator concerning the exercise of the administrator's powers under this code and may make recommendations to the administrator. Members of the council may assist the administrator in obtaining compliance with this code. Since it is an objective of this part 3 to obtain competent representatives of creditors and the public to serve on the council and to assist and cooperate with the administrator in achieving the objectives of this code, service on the council shall not in itself constitute a conflict of interest regardless of the occupations or associations of the members.

(2) (a) There is hereby created a subcommittee of the council of advisors on consumer credit for the purpose specified in paragraph (b) of this subsection (2). The subcommittee shall consist of the attorney general, the chairperson of the council, and three members of the council appointed by such chairperson. Of the subcommittee members who are also members of the council, two shall be representatives of the consumer credit industry and two shall be representatives of the public. Any action taken by a majority of the subcommittee shall constitute action by the council.

(b) The subcommittee may review, repeal, amend, or modify any rule promulgated by the administrator pursuant to section 5-6-104 (1) (e).

Source: L. 2000: Entire article R&RE, p. 1254, § 1, effective July 1.

Editor's note: This section is similar to former § 5-6-302, as it existed prior to 2000.

ARTICLE 7

Insurance Premium Financing

5-7-101 to 5-7-103. (Repealed)

Source: L. 2001: Entire article repealed, p. 30, § 15, effective March 9.

Editor's note: This article was added in 1977. For amendments to this article prior to its repeal in 2001, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

ARTICLE 9

Effective Date

Editor's note: This title was repealed and reenacted in 1971. This article was numbered as article 9 of chapter 73, C.R.S. 1963. For historical information concerning the repeal and reenactment of this title in 1971, see the editor's note immediately following the title heading for this title.

5-9-101. Time of taking effect prior to June 30, 2000 - provisions for transition. (1) Except as otherwise provided in this section, this code as it existed prior to the enactment of House Bill 00-1185, as enacted at the second regular session of the sixty-second general assembly, took effect at 12:01 a.m. on October 1, 1971, and was in effect through June 30, 2000.

(2) To the extent appropriate to permit the administrator to prepare for operation of this code as it existed prior to the enactment of House Bill 00-1185, as enacted at the second regular session of the sixty-second general assembly, when it took effect and to act on applications for licenses to make supervised loans under this code as it existed prior to the enactment of House Bill 00-1185, as enacted at the second regular session of the sixty-second general assembly, (subsection (1) of section 5-3-503), the provisions on supervised loans (part 5) of the article on loans (article 3 of this title) and of the article on administration (article 6 of this title) took effect on July 1, 1971, and were in effect through June 30, 2000.

(3) Transactions entered into before October 1, 1971, and the rights, duties, and interests flowing from them thereafter, may be terminated, completed, consummated, or enforced as required or permitted by any statute, rule of law, or other law amended, repealed, or modified by this code as though the repeal, amendment, or modification had not occurred, but this code, as it existed prior to the enactment of House Bill 00-1185, as enacted at the second regular session of the sixty-second general assembly, applies to:

(a) Refinancings, consolidations, and deferrals made on or after October 1, 1971, and before July 1, 2000, concerning sales, leases, and loans whenever made;

(b) Sales or loans made on or after October 1, 1971, and before July 1, 2000, pursuant to revolving charge accounts (section 5-2-108) and revolving loan accounts (section 5-3-108) entered into, arranged, or contracted for before October 1, 1971; and

(c) All credit transactions made before October 1, 1971, insofar as the article on remedies and penalties (article 5 of this title) limits the remedies of creditors.

(4) With respect to revolving charge accounts (section 5-2-108) and revolving loan accounts (section 5-3-108) entered into, arranged, or contracted for before October 1, 1971, disclosure pursuant to the provisions on disclosure (section 5-2-310 and section 5-3-309), shall be made not later than thirty days after October 1, 1971.

Source: L. 71: R&RE, p. 851, § 1. **C.R.S. 1963:** § 73-9-101. **L. 2000:** (1), (2), (3)(a), and (3)(b) amended, p. 1255, § 2, effective July 1.

Editor's note: The provisions referenced in this section reflect the provisions as they existed prior to the repeal and reenactment of articles 2 and 3 of this title in 2000. For the referenced provisions, see the 1999 Colorado Revised Statutes.

OFFICIAL COMMENT

The 30-day period in subsection (4) is derived from CCPA Section 127 (c) [15 U.S.C.A. Section 1637(c)].

COLORADO COMMENT

Subsection (3)(c) makes the remedies and penalties provisions of this Code prospectively applicable to creditors under credit transactions entered into prior to October 1, 1971.

5-9-101.5. Time of taking effect - provisions for transition. (1) Except as otherwise provided in this section, this code as it exists following the repeal and reenactment contained in House Bill 00-1185, as enacted at the second regular session of the sixty-second general assembly, takes effect at 12:01 a.m. on July 1, 2000.

(2) Transactions entered into before July 1, 2000, and the rights, duties, and interests flowing from them thereafter, may be terminated, completed, consummated, or enforced as required or permitted by any statute, rule of law, or other law amended, repealed, or modified by this code as though the repeal, amendment, or modification had not occurred, but this code applies to:

(a) Refinancings, consolidations, and deferrals made on or after July 1, 2000, concerning sales, leases, and loans whenever made;

(b) Sales or loans made on or after July 1, 2000, pursuant to revolving credit accounts entered into, arranged, or contracted for before July 1, 2000; and

(c) All credit transactions made before July 1, 2000, insofar as article 5 of this title limits the remedies of creditors. Notwithstanding anything to the contrary, the disclosures described in sections 5-3-105 (5), 5-3-106, 5-5-110 (4), and 5-5-111 (3) of this code take effect January 1, 2001.

Source: L. 2000: Entire section added, p. 1256, § 4, effective July 1.

5-9-102. Continuation of licensing prior to July 1, 2000. Notwithstanding the repeal and reenactment of articles 2 and 3 of chapter 73, C.R.S. 1963, by this code, all persons licensed or otherwise authorized under the provisions of articles 2 or 3 of chapter 73, C.R.S. 1963, immediately prior to October 1, 1971, are licensed to make supervised loans under this code as it existed prior to the enactment of House Bill 00-1185, as enacted at the second regular session of the sixty-second general assembly, pursuant to the provisions on supervised loans of the article on loans (part 5 of article 3 of this title) in effect on and after October 1, 1971, but before July 1, 2000, and all provisions of said sections apply to the persons so previously licensed or authorized. The administrator may, but is not required to, deliver evidence of licensing to the persons so previously licensed or authorized.

Source: L. 71: R&RE, p. 851, § 1. **C.R.S. 1963:** § 73-9-102. **L. 2000:** Entire section amended, p. 1256, § 3, effective July 1.

OFFICIAL COMMENT

This section provides automatic licensing under Article 3, Part 5 [Section 5-3-501 et seq.] for all lenders previously licensed under the State's licensed lender statutes prior to the effective date. No application or administrative action is required and the formal license under the prior statute, which will be repealed, will be a license under Part 5 of Article 3. The Administrator, at such time as his new duties under the Code permit him an opportunity, may substitute new licenses for those in the lenders' possession, but this is entirely a ministerial act.

5-9-102.5. Continuation of licensing after July 1, 2000. Notwithstanding the repeal and reenactment of part 5 of article 3 of this title by House Bill 00-1185, as enacted at the second regular session of the sixty-second general assembly, all persons licensed or otherwise authorized under the provisions of part 5 of article 3 immediately prior to July 1, 2000, are licensed to make supervised loans under this code pursuant to the provisions on supervised loans contained in part 3 of article 2 of this title, and all provisions of said part 3 apply to the persons so previously licensed or authorized. The administrator may, but is not required to, deliver evidence of licensing to the persons so previously licensed or authorized.

Source: L. 2000: Entire section added, p. 1256, § 4, effective July 1.

5-9-103. (Reserved)

ARTICLE 9.5

Refund Anticipation Loans

5-9.5-101. Short title. This article shall be known and may be cited as the "Refund Anticipation Loans Act".

Source: L. 2010: Entire article added, (HB 10-1400), ch. 237, p. 1034, § 1, effective November 1.

5-9.5-102. Legislative declaration - scope. The general assembly hereby finds, determines, and declares that it is in the interest of the public health, safety, and welfare to enact minimum protections for the benefit of consumers availing themselves of refund anticipation loans offered by facilitators.

Source: L. 2010: Entire article added, (HB 10-1400), ch. 237, p. 1034, § 1, effective November 1.

5-9.5-103. Definitions. As used in this article, unless the context otherwise requires:

(1) "Administrator" means the administrator designated in section 5-6-103.

(2) "Consumer" means a natural person who is solicited for, applies for, or receives the proceeds of a refund anticipation loan.

(3) "Electronic return originator" means a person authorized by the internal revenue service to originate the electronic submission of income tax returns to the internal revenue service.

(4) "Person" has the meaning set forth in section 2-4-401, C.R.S.

(5) "Refund anticipation loan" means a loan made to a Colorado consumer based on the Colorado consumer's anticipated income tax refund.

(6) (a) "Refund anticipation loan facilitator" or "facilitator" means a person who, individually or in conjunction or cooperation with another person, solicits the execution of, processes, arranges for, receives, or accepts an application or agreement for a refund anticipation loan or in any other manner facilitates the making of a refund anticipation loan and includes an electronic return facilitator.

(b) "Refund anticipation loan facilitator" does not include a person validly:

(I) Doing business as a bank, thrift, savings association, or credit union under the laws of the United States or of this state or is an affiliate of such an entity that is acting as a servicer for that entity;

(II) Practicing as a certified public accountant licensed under article 2 of title 12, C.R.S.; or

(III) Licensed as an attorney by the Colorado supreme court in accordance with section 12-5-101, C.R.S.

Source: L. 2010: Entire article added, (HB 10-1400), ch. 237, p. 1034, § 1, effective November 1.

5-9.5-104. Restriction on facilitating refund anticipation loans. A person shall not act as a refund anticipation loan facilitator unless the person is, or is directly employed by, an electronic return originator.

Source: L. 2010: Entire article added, (HB 10-1400), ch. 237, p. 1035, § 1, effective November 1.

5-9.5-105. Disclosures required. (1) A facilitator shall not facilitate a refund anticipation loan unless the facilitator makes the disclosures required by subsections (2), (3), and (4) of this section.

(2) **Fee schedule to be posted.** (a) Every place of business in which facilitators facilitate refund anticipation loans shall post a schedule showing the current fees for facilitating refund anticipation loans and for the electronic filing of a consumer's tax return.

(b) Each fee schedule posted pursuant to this subsection (2) shall contain examples of the refund anticipation loan annual percentage rates for refund anticipation loans of two hundred dollars, five hundred dollars, one thousand dollars, one thousand five hundred dollars, two thousand dollars, and five thousand dollars.

(c) Each fee schedule shall also prominently contain the following statement, in at least twenty-eight-point, bold-faced type and in both English and Spanish:

NOTICE

When you take out a refund anticipation loan, you are taking out a loan by borrowing money against your tax refund. If your tax refund is less than expected, you will still owe the entire amount of the loan. If your refund is delayed, you may have to pay additional costs. YOU CAN USUALLY GET YOUR REFUND IN 8 TO 15 DAYS WITHOUT GETTING A LOAN OR PAYING EXTRA FEES. You can have your tax return filed electronically and your refund direct-deposited into your own bank account without obtaining a loan or other paid product. You can make complaints regarding your refund anticipation loan to the administrator of the Uniform Consumer Credit Code in the Colorado state attorney general's office at [current telephone number].

(d) The fee schedule and notice required by this subsection (2) shall be made on a sign measuring no less than sixteen inches by twenty inches and shall be displayed conspicuously and in a prominent location.

(3) **Oral disclosures.** (a) When a consumer applies for a refund anticipation loan, the facilitator shall orally disclose to the consumer:

(I) That the product is a loan that only lasts one to two weeks;

(II) That, if the consumer's tax refund is less than expected, the consumer is liable for the full amount of the loan and must repay any difference;

(III) The amount of the refund anticipation loan fee; and

(IV) The refund anticipation loan interest rate.

(b) The oral disclosure required under this subsection (3) shall be made in English, Spanish, or any other language that the facilitator uses to communicate orally with the consumer.

(4) **Written statement.** (a) When a consumer applies for a refund anticipation loan and before closing the refund anticipation loan, the facilitator facilitating the loan shall give the consumer a written statement informing the consumer:

(I) That a refund anticipation loan is a loan and is not the borrower's actual income tax refund;

(II) That the consumer may file an income tax return electronically without applying for a refund anticipation loan;

(III) That the consumer is responsible for repayment of the loan and related fees if the tax refund is not paid or is insufficient to repay the loan;

(IV) Any fee that will be charged if the loan is not approved;

(V) The average time, as published by the federal internal revenue service, within which a taxpayer can expect to receive a refund for an income tax return filed:

(A) Electronically, and the refund is deposited directly into the taxpayer's financial institution account or mailed to the taxpayer; and

(B) By mail, and the refund is deposited directly into the taxpayer's financial institution account or mailed to the taxpayer;

(VI) That the federal internal revenue service does not guarantee:

(A) Payment of the full amount of the anticipated refund;

(B) A specific date on which it will mail a refund or deposit the refund into a taxpayer's financial institution account; or

(C) The estimated time within which the proceeds of the refund anticipation loan will be paid to the consumer if the loan is approved;

(VII) The following information, specific to the consumer:

(A) The total fees for the loan; and

(B) The estimated annual percentage rate for the loan, calculated using the guidelines established under the federal "Truth in Lending Act", 15 U.S.C. sec. 1601 et seq., as amended;

(VIII) The procedure for making a complaint to the administrator regarding the refund anticipation loan, including the current address, telephone number, or web site of the administrator to which such complaints may be directed.

(b) The written statement required under this subsection (4) shall be provided to the consumer in English, Spanish, or both English and Spanish, as requested by the consumer.

Source: L. 2010: Entire article added, (HB 10-1400), ch. 237, p. 1035, § 1, effective November 1.

5-9.5-106. Unlawful acts - fine. Any person who willfully violates this article is guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine not to exceed five hundred dollars or by imprisonment in the county jail for not more than one year, or by both such fine and imprisonment.

Source: L. 2010: Entire article added, (HB 10-1400), ch. 237, p. 1037, § 1, effective November 1.

5-9.5-107. Enforcement - investigation - penalties. (1) The administrator shall enforce this article. To carry out this responsibility, the administrator is authorized to:

(a) Receive and act on complaints, take action designed to obtain voluntary compliance with this article, or commence proceedings on the administrator's own initiative;

(b) Issue and enforce cease-and-desist or other administrative enforcement orders in the same manner as set forth in section 5-6-109;

(c) Make investigations, issue subpoenas to require the attendance of witnesses or the production of documents, administer oaths, and conduct hearings in aid of any investigation or inquiry necessary to administer the provisions of this article;

(d) Bring a civil action to restrain a person from violating this article and for other appropriate relief in the same manner as set forth in sections 5-6-111 to 5-6-114 and assess a civil penalty of up to one thousand dollars per violation; and

(e) Use any of the administrator's enforcement powers to restrain or take other action against any person found to be facilitating or enforcing refund anticipation loans in violation of this article.

Source: L. 2010: Entire article added, (HB 10-1400), ch. 237, p. 1037, § 1, effective November 1. **L. 2011:** (1)(d) amended, (HB 11-1221), ch. 121, p. 381, § 1, effective July 1.

5-9.5-108. Severability. If any provision of this article or the application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of the article that can be given effect without the invalid provision or application, and to this end the provisions of this article are declared to be severable.

Source: L. 2010: Entire article added, (HB 10-1400), ch. 237, p. 1038, § 1, effective November 1.

5-9.5-109. Repeal of article. (1) This article is repealed, effective September 1, 2019.

(2) Prior to the repeal of this article, the functions of the administrator under this article shall be reviewed as provided for in section 24-34-104 (50.5), C.R.S.

Source: L. 2010: Entire article added, (HB 10-1400), ch. 237, p. 1038, § 1, effective November 1.

RENTAL PURCHASE

ARTICLE 10

Rental Purchase Agreements

PART 1

GENERAL PROVISIONS

5-10-101. Short title. This article shall be known and may be cited as the "Colorado Rental Purchase Agreement Act".

Source: L. 90: Entire article added, p. 366, § 1, effective January 1, 1991.

5-10-102. Legislative declaration. (1) This article shall be liberally construed and applied to promote its underlying purposes and policies.

(2) The underlying purposes and policies of this article are to:

(a) Simplify, clarify, and modernize the law governing rental purchase agreements;

(b) Provide certain disclosures to consumers who enter into rental purchase agreements and to promote consumer understanding of the terms of rental purchase agreements;

(c) To protect consumers against unfair practices by some rental purchase dealers, having due regard for the interest of legitimate and scrupulous rental dealers; and

(d) To permit and encourage the development of fair and economically sound rental purchase practices.

Source: L. 90: Entire article added, p. 366, § 1, effective January 1, 1991.

5-10-103. Waiver - agreement to forego rights - prohibited. Except as otherwise provided in this article, a lessor or lessee, as those terms are defined in section 5-10-301, may not waive or agree to forego rights or benefits under this article, and any attempt to waive or agree to forego such rights or benefits is void.

Source: L. 90: Entire article added, p. 367, § 1, effective January 1, 1991.

5-10-104. Effective date. Notwithstanding the provisions of section 5-9-101, this article shall take effect January 1, 1991.

Source: L. 90: Entire article added, p. 367, § 1, effective January 1, 1991.

5-10-105. Supplementary general principles of law applicable. Unless displaced by the particular provisions of this article, the "Uniform Commercial Code" and the principles of law and equity, including the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, or other validating or invalidating cause, supplement the provisions of this article.

Source: L. 90: Entire article added, p. 367, § 1, effective January 1, 1991.

Cross references: For the "Uniform Commercial Code", see title 4.

PART 2

SCOPE OF ARTICLE

5-10-201. Application. (1) This article shall apply to a rental purchase agreement, or acts, practices, or conduct relating to a rental purchase agreement if:

(a) The rental purchase agreement is entered into in this state; or

(b) The lessee is a resident of this state at the time the lessor offering the rental purchase agreement solicits the rental purchase agreement or modification thereof, whether such solicitation is made personally, by mail, or by telephone.

(2) For the purposes of this article, the residence of the lessee is the address given by the lessee as the lessee's residence in any writing signed by the lessee in connection with the rental purchase agreement. Unless the lessee notifies the lessor in writing of a new or different residence address, the given residence address is presumed to be unchanged.

Source: L. 90: Entire article added, p. 367, § 1, effective January 1, 1991.

5-10-202. Exclusions. (1) This article shall not apply to, and an agreement that complies with this article is not governed by the provision relating to:

(a) A "consumer credit sale" as that term is defined in section 5-1-301 (11);

(b) A "consumer lease" as that term is defined in section 5-1-301 (14);

(c) A "consumer loan" as that term is defined in section 5-1-301 (15);

(d) and (e) Repealed.

(f) A "home solicitation sale" as that term is defined in section 5-3-401;

(g) A "sale of goods" as that term is defined in section 5-1-301 (39);

(h) A "security interest" as that term is defined in section 4-1-201 (b) (35), C.R.S.;

(i) Any lease for agricultural, business, or commercial purposes;

(j) Any lease of money or intangible personal property.

Source: L. 90: Entire article added, p. 367, § 1, effective January 1, 1991. **L. 96:** (1)(d) and (1)(e) repealed, p. 407, § 11, effective July 1. **L. 2000:** IP(1), (1)(a), (1)(b), (1)(c), (1)(f), and (1)(g) amended, p. 1870, § 101, effective August 2. **L. 2006:** (1)(h) amended, p. 503, § 45, effective September 1.

PART 3

DEFINITIONS

5-10-301. Definitions. (1) As used in this article, unless otherwise required by the context:

(a) "Administrator" means the administrator designated in section 5-6-103.

(b) "Advertisement" means a commercial message in any medium that aids, promotes, or assists, directly or indirectly, a rental purchase agreement.

(c) "Cash price" means the price at which a lessor in the ordinary course of business would offer the property that is the subject of a rental purchase agreement to the lessee for cash on the date of the execution of the rental purchase agreement.

(d) "Consummate" means the act of the lessee in entering into a rental purchase agreement.

(e) "Lessee" means a natural person who rents personal property under a rental purchase agreement.

(f) "Lessor" means a person, firm, or corporation who in the ordinary course of business, regularly leases, offers to lease, or arranges for the leasing of property under a rental purchase agreement.

(g) "Liability damage waiver" means a contract or contractual provision, whether separate from or a part of a rental purchase agreement, whereby the lessor agrees, for a charge, to waive any and all claims against the lessee for any damages to, or loss of, the property which is the subject of the rental purchase agreement during the term of the rental agreement.

(h) "Period" means a day, week, month, or other subdivision of the year.

(i) "Personal property" means any property which is made available for a rental purchase agreement and which is not considered real property under the laws of this state.

(j) "Rental purchase agreement" means an agreement for the use of personal property by an individual primarily for personal, family, or household purposes, for an initial period of four months or less, whether or not there is any obligation beyond the initial period, that is automatically renewable with each payment and that permits the lessee to become the owner of the property.

Source: L. 90: Entire article added, p. 368, § 1, effective January 1, 1991.

PART 4

DISCLOSURES AND FORM OF WRITING

5-10-401. Disclosures. (1) A lessor shall disclose to a lessee in a rental purchase agreement the information required either by this part 4 or by the provisions of the federal "Consumer Credit Protection Act" if the federal "Consumer Credit Protection Act" is amended to cover disclosure in a rental purchase agreement. In a rental purchase agreement, the lessor shall disclose the following:

(a) A brief description of the leased property, sufficient to identify the property to the lessee and lessor;

(b) The total number of payments and the total amount of such payments necessary to acquire ownership;

(c) The number, amount, and timing of each payment, including taxes paid to or through the lessor;

(d) A statement that the lessee will not own the property until the lessee has made the total number of payments and the total amount of such payments necessary to acquire ownership;

(e) A statement of all other charges which the lessee may have to pay together with the amount of any such charge and the conditions under which any such charge shall be incurred;

(f) If applicable, a statement that the lessee is responsible for the fair market value of the property if and as of the time it is lost, stolen, damaged, or destroyed;

(g) A statement indicating whether the property is new or used; except that it is not a violation of this paragraph (g) to indicate that the property is used if it is actually new;

(h) A statement that, at any time after the first lease payment is made, the lessee may acquire ownership of the property, and a brief explanation of the price, formula, or other method for determining the price at which the property may be purchased;

(i) A brief explanation of the lessee's right to reinstate, and a description of the amount, or method of determining the amount, of any penalty or other charge for reinstatement as established in section 5-10-602;

(j) The cash price of the property subject to the rental purchase agreement; and

(k) A statement of the maintenance services, if any, the lessor will provide with respect to the property subject to the rental purchase agreement.

(2) In addition to the disclosures required pursuant to subsection (1) of this section, the lessor shall also make the following disclosure:

NOTICE TO LESSEE — READ BEFORE SIGNING

(1) DO NOT SIGN THIS BEFORE YOU READ THE ENTIRE AGREEMENT INCLUDING ANY WRITING ON THE REVERSE SIDE, EVEN IF OTHERWISE ADVISED.

(2) DO NOT SIGN THIS IF IT CONTAINS ANY BLANK SPACES.

(3) YOU ARE ENTITLED TO AN EXACT COPY OF ANY AGREEMENT YOU SIGN.

(4) YOU HAVE THE RIGHT TO EXERCISE ANY EARLY BUY-OUT OPTION AS PROVIDED IN THIS AGREEMENT. EXERCISE OF THIS OPTION MAY RESULT IN A REDUCTION OF YOUR TOTAL COST TO ACQUIRE OWNERSHIP UNDER THIS AGREEMENT.

(5) IF YOU ELECT TO MAKE WEEKLY RATHER THAN MONTHLY PAYMENTS AND EXERCISE YOUR PURCHASE OPTION, YOU MAY PAY MORE FOR THE LEASED PROPERTY.

Source: L. 90: Entire article added, p. 368, § 1, effective January 1, 1991.

Cross references: For the federal "Consumer Credit Protection Act", see Pub.L. 90-321.

5-10-402. Form requirements. (1) The information required by this part 4:

(a) Shall be disclosed in writing in a rental purchase agreement;

(b) Shall be set forth clearly and conspicuously, in not less than eight point standard type;

(c) Shall be set apart and not contain any information not directly related to the disclosures;

(d) Shall be stated using words and phrases of common meaning;

(e) Need not be contained in a single writing or made in the order set forth in this part 4; and

(f) May be supplemented by additional information or explanations supplied by the lessor, so long as the additional information is not stated, utilized, or placed in a manner which will confuse the lessee or contradict, obscure, or distract attention from the required information. The additional information or explanations shall not have the effect of circumventing, evading, or unduly complicating the information required to be disclosed.

(2) The lessor shall disclose all information required by this part 4 before the rental purchase agreement is consummated.

(3) Before any payment is due, the lessor shall furnish the lessee with an exact copy of the rental purchase agreement, which shall be signed by the lessee and which shall evidence the lessee's agreement. If there is more than one lessee in a rental purchase agreement, delivery of a copy of the rental purchase agreement to one of the lessees constitutes compliance with this subsection (3).

Source: L. 90: Entire article added, p. 370, § 1, effective January 1, 1991.

5-10-403. Receipts. The lessor shall furnish the lessee a written receipt for each payment made in cash or by any other method of payment that does not provide evidence of payment when any such payment is delivered in person during normal working hours.

Source: L. 90: Entire article added, p. 370, § 1, effective January 1, 1991.

PART 5

LIMITATION ON AGREEMENTS AND PRACTICES

5-10-501. Acquiring ownership. At any time after the first lease payment is made, the lessee may acquire ownership of the property under the terms specified in the rental purchase agreement.

Source: L. 90: Entire article added, p. 370, § 1, effective January 1, 1991.

5-10-502. Prohibited provisions. (1) A rental purchase agreement shall not contain a provision requiring any of the following:

(a) Assignment of earnings. No lessor shall accept an assignment of earnings from the lessee for payment or as security for payment of a charge arising out of a rental purchase agreement. An assignment of earnings in violation of this paragraph (a) is unenforceable by the assignee of the earnings and revocable by the lessee. This paragraph (a) shall not prohibit a lessee from voluntarily authorizing deductions from his earnings if the authorization is revocable and otherwise permitted by law.

(b) Authorization to confess judgment. No lessor shall take or accept a power of attorney or other authorization from the lessee, or other person acting on his behalf, to confess judgment.

(c) Waivers. No lessor may require a lessee to waive service of process or to waive any defense, counterclaim, or right of action against the lessor, or a person acting on the lessor's behalf as the lessor's agent in collection of payments under the lease or in the repossession of the lease property.

(d) Breach of the peace. No lessor may require a lessee to authorize the lessor or a person acting on the lessor's behalf to enter unlawfully upon the lessee's premises or to commit any breach of the peace in the repossession of the lease property.

(e) Garnishment of wages. No lessor may require a lessee to authorize a prejudgment garnishment of the lessee's wages.

Source: L. 90: Entire article added, p. 370, § 1, effective January 1, 1991.

5-10-503. Balloon payments. A lessee shall not be required to make a payment in addition to regular lease payments in order to acquire ownership of the lease property, nor shall the lessee be required to pay lease payments totaling more than the cost to acquire ownership, as provided in section 5-10-401 (1) (b).

Source: L. 90: Entire article added, p. 371, § 1, effective January 1, 1991.

5-10-504. Prohibited charges. (1) A lessor shall not contract for or receive charges for any of the following:

(a) The purchase of insurance by the lessee from the lessor;

(b) A penalty for early termination of a rental purchase agreement or for the return of an item at any point, except for those charges authorized by sections 5-10-601 and 5-10-602; or

(c) A payment by a co-signer of the rental purchase agreement for any fees or charges which could not be imposed upon the lessee as part of the rental purchase agreement.

(2) No payment or obligation on the part of the lessee shall accrue when the property is being repaired or replaced unless a loaner is provided to the lessee.

Source: L. 90: Entire article added, p. 371, § 1, effective January 1, 1991.

PART 6

LIMITATIONS ON CHARGES

5-10-601. Additional charges. (1) A lessor may contract for and receive an initial nonrefundable fee not to exceed ten dollars per contract. Should any security deposit be required by the lessor, the amount of such deposit and the conditions under which it will be returned shall be disclosed with the disclosures required by section 5-10-401.

(2) A lessor may contract for and receive an initial delivery charge per contract not to exceed fifteen dollars in the case of a rental purchase agreement covering five or fewer items and a delivery charge not to exceed forty-five dollars in the case of a rental purchase agreement covering more than five items, if, in either case, the lessor actually delivers the items to the lessee's dwelling and the delivery charge is disclosed with the disclosures required by section 5-10-401. Said delivery charge shall be assessed in lieu of and not in addition to the initial charge in subsection (1) of this section. A lessor may not contract for or receive a delivery charge on property redelivered after repair or maintenance.

(3) A lessor may contract for and receive a charge for picking up late payments from the lessee if the lessor is required to do so pursuant to the rental purchase agreement or is requested to visit the lessee to pick up a payment. In a rental purchase agreement with payment or renewal dates which are on a monthly basis, this charge may not be assessed more than three times in any six-month period. In rental purchase agreements with payments or renewal options on a weekly or biweekly basis, this charge may not be assessed more than six times in any six-month period. No charge assessed pursuant to this subsection (3) may exceed ten dollars. A pickup fee may be assessed pursuant to this subsection (3) only in lieu of and not in addition to any late charge assessed pursuant to subsection (4) of this section.

(4) (a) The parties may contract for late charges as follows:

(I) For rental purchase agreements with monthly renewal dates, a late charge not exceeding five dollars may be assessed on any payment not made within five days after payment is due, or return of the property is required.

(II) For rental purchase agreements with weekly or bi-weekly renewal dates, a late charge not exceeding three dollars may be assessed on any payments not made within three days after payment is due, or return of the property is required.

(b) A late charge on a rental purchase agreement may be collected only once on any accrued payment, no matter how long it remains unpaid. A late charge may be collected at the time it accrues or at any time thereafter. A lessor may elect to waive imposition of a late charge due on an accrued payment in accordance with the terms of the rental purchase agreement; except that, such waiver shall be in writing and, once a late charge is waived for a specific payment, the lessor may not thereafter seek to impose a late fee for the accrued payment in question. No late charge may be assessed against a payment that is timely made, even though an earlier late charge has not been paid in full.

Source: L. 90: Entire article added, p. 371, § 1, effective January 1, 1991.

5-10-602. Reinstatement fees. A reinstatement fee as provided for in section 5-10-701 shall equal the outstanding balance of any accrued missed payments and late charges plus an additional fee not to exceed five dollars.

Source: L. 90: Entire article added, p. 372, § 1, effective January 1, 1991.

5-10-603. Liability damage waivers - fees. (1) In addition to the other charges permitted by this part 6, the parties may contract for a liability waiver fee not to exceed the greater of ten percent of any periodic lease payment due or two dollars in the case of any rental purchase agreement with weekly or biweekly renewal dates, and not to exceed the greater of ten percent of any periodic lease payment due or five dollars in the case of any rental purchase agreement with monthly renewal dates. The selling or offering for sale of

a liability damage waiver pursuant to this article is subject to the following prohibitions and requirements:

(a) A lessor may not sell or offer to sell a liability damage waiver unless all restrictions, conditions, and exclusions are printed in the rental purchase agreement, or in a separate agreement, in eight-point type, or larger, or written in pen and ink or typewritten in or on the face of the rental purchase agreement in a blank space provided therefor. The liability damage waiver may exclude only loss or damage to the property which is the subject of the rental purchase agreement due to moisture, scratches, mysterious disappearance, vandalism, abandonment of the property, or due to any other damages caused intentionally by the lessee or which result from the lessee's willful or wanton misconduct.

(b) The liability damage waiver agreement must include a statement of the total charge for the liability damage waiver. The liability damage waiver agreement must display in eight-point boldface type the following notice:

> NOTICE: THIS CONTRACT OFFERS, FOR AN ADDITIONAL CHARGE, A LIABILITY DAMAGE WAIVER TO COVER YOUR RESPONSIBILITY FOR DAMAGE TO THE PROPERTY. BEFORE DECIDING WHETHER TO PURCHASE THE LIABILITY DAMAGE WAIVER, YOU MAY WISH TO DETERMINE WHETHER YOUR OWN HOMEOWNERS OR CASUALTY INSURANCE AFFORDS YOU COVERAGE FOR DAMAGE TO THE RENTAL PROPERTY, AND THE AMOUNT OF THE DEDUCTIBLE UNDER YOUR OWN INSURANCE COVERAGE. THE PURCHASE OF THIS LIABILITY DAMAGE WAIVER IS NOT MANDATORY AND MAY BE DECLINED.

(c) The restrictions, conditions, and exclusions of the liability damage waiver must be disclosed on a separate agreement, sheet, or handout given to the lessee prior to entering into the rental purchase agreement. The separate contract, sheet, or handout must be signed, or otherwise acknowledged by the lessee as being received prior to entering into the rental purchase agreement.

Source: L. 90: Entire article added, p. 372, § 1, effective January 1, 1991.

5-10-604. Taxes. In addition to those charges allowable by this part 6, the lessor may require the lessee to pay all applicable state sales and use taxes levied in connection with the rental purchase agreement.

Source: L. 90: Entire article added, p. 373, § 1, effective January 1, 1991.

PART 7

REMEDIES

5-10-701. Lessee's remedies - reinstatement. (1) A lessee who breaches any rental purchase agreement, including but not limited to the failure to make timely rental payments, has the right to reinstate the original rental purchase agreement without losing any rights or options previously acquired under the rental purchase agreement if both of the following apply:

(a) Subsequent to having failed to make a timely rental payment, the lessee has promptly surrendered the property to the lessor, in the manner as set forth in the rental purchase agreement, and if and when requested by lessor; and

(b) Not more than sixty days have passed since the lessee returned the lease property; except that if the lessee has made more than sixty percent of the total number of payments required under the rental purchase agreement to acquire ownership, such sixty-day period shall be extended to a one-hundred-twenty-day period.

(2) As a condition precedent to reinstatement of the rental purchase agreement, a lessor may collect a reinstatement fee as set forth in section 5-10-602, plus delivery charges allowable by section 5-10-601 (2) if redelivery of the item is necessary.

(3) If reinstatement occurs pursuant to this section, the lessor shall provide the lessee with either the same item leased by the lessee prior to reinstatement or a substitute item of equivalent quality and condition. If a substitute item is provided, the lessor shall provide the lessee with all the information required by section 5-10-401.

Source: L. 90: Entire article added, p. 373, § 1, effective January 1, 1991.

5-10-702. Limitations on lessor's remedies. With respect to a debt arising from a rental purchase agreement, regardless of where made, the lessor may not attach unpaid earnings of the debtor by garnishment or like proceedings prior to the entry of judgment in an action against the lessee arising from the said rental purchase agreement.

Source: L. 90: Entire article added, p. 374, § 1, effective January 1, 1991.

5-10-703. Assignee liability. (1) With respect to a rental purchase agreement, an assignee of the rights of the lessor is subject to all claims and defenses of the lessee against the lessor arising from the lease of property or services, notwithstanding that the assignee is the holder in due course of a negotiable instrument issued in violation of the provisions prohibiting certain negotiable instruments.

(2) A claim or defense of a lessee specified in subsection (1) of this section may be asserted against the assignee under this section only to the extent of the amount owing and paid to the assignee and assignor.

(3) An agreement may not limit or waive the claims or defenses of a lessee under this section.

Source: L. 90: Entire article added, p. 374, § 1, effective January 1, 1991.

5-10-704. Notice of assignment. The lessee is authorized to pay the original lessor until the lessee receives written notification that the rights to payment pursuant to a rental purchase agreement have been assigned to an assignee and that payment is to be made to the assignee. A notification which does not reasonably identify the rights assigned shall be ineffective. If requested by the lessee, the assignee shall furnish reasonable proof that the assignment has been made, and, unless he does so, the lessee may pay the lessor.

Source: L. 90: Entire article added, p. 374, § 1, effective January 1, 1991.

PART 8

ENFORCEMENT

5-10-801. Administrator responsibility. (1) The administrator shall enforce this article. To carry out this responsibility, the administrator shall be authorized to:

(a) Receive and act on complaints, take action designed to obtain voluntary compliance with this article, or commence proceedings on the administrator's own initiative;

(b) Issue and enforce cease and desist or other administrative enforcement orders in the same manner as set forth in section 5-6-109;

(c) Counsel persons and groups on their rights and duties under this article;

(d) Establish programs for the education of consumers with respect to rental purchase agreement practices and problems;

(e) Bring a civil action to restrain a person from violating this article and for other appropriate relief in the same manner as set forth in sections 5-6-111 to 5-6-114 and for a civil penalty of up to one thousand dollars per violation; and

(f) Use any of his enforcement powers to restrain or take other action against any person found to be making or enforcing rental purchase agreements which contain any unconscionable provisions or clauses.

Source: L. 90: Entire article added, p. 374, § 1, effective January 1, 1991. **L. 2000:** (1)(b) and (1)(e) amended, p. 1870, § 102, effective August 2. **L. 2011:** (1)(e) amended, (HB 11-1221), ch. 121, p. 381, § 2, effective July 1.

5-10-802. Lessor's records and investigations. (1) In administering this article and in order to determine compliance with this article, the administrator may examine the books and records of persons subject to the article and may make investigations of persons necessary to determine compliance. For this purpose, the administrator may administer oaths or affirmations, and, upon the administrator's own motion or upon request of any party, may subpoena witnesses, compel their attendance, compel testimony, and require the production of any matter that is relevant to the investigation, including the existence, description, nature, custody, condition, and location of, any books, documents, or other tangible things and the identity and location of persons having knowledge of relevant facts, or any other matter reasonably calculated to lead to the discovery of admissible evidence. If the administrator prevails in any civil action brought as a result of such an investigation, the court shall award the administrator costs and a reasonable attorney fee.

(2) If the person's records are located outside Colorado, the person shall, at the person's option, either make them available to the administrator at a convenient location in Colorado, or pay the reasonable and necessary expenses for the administrator or the administrator's representative to examine them at the place where they are maintained. The administrator may designate representatives, including comparable officials of the state in which the records are located, to inspect them on the administrator's behalf.

(3) Upon failure without lawful excuse to obey a subpoena or to give testimony and upon reasonable notice to all persons affected thereby, the administrator may apply to a court for an order compelling compliance.

(4) The administrator may not make public the name or identity of a person whose acts or conduct the administrator investigates under this section or the facts disclosed in the investigation, but this subsection (4) shall not apply to disclosures in actions or enforcement proceedings under this article.

Source: L. 90: Entire article added, p. 375, § 1, effective January 1, 1991.

5-10-803. Assurance of discontinuance. If it is claimed that a person has engaged in conduct subject to an order by the administrator or by a court under this article, the administrator may accept an assurance in writing that the person will not engage in the conduct in the future. If a person giving an assurance of discontinuance fails to comply with its terms, the assurance shall be evidence that before the assurance the person engaged in the conduct described in the assurance.

Source: L. 90: Entire article added, p. 375, § 1, effective January 1, 1991.

5-10-804. Notification by lessors - contents. (1) A lessor shall file a notification as prescribed in subsection (2) of this section with the administrator:

(a) Within thirty days after soliciting or entering into a rental purchase agreement subject to this article; and

(b) Before February 1 in each subsequent year that the lessor solicits or enters into a rental purchase agreement subject to this article.

(2) The notification required under subsection (1) of this section shall state the following:

(a) The name of the lessor and, if different, the name in which business is transacted;

(b) The address of the lessor's principal office, which may be outside Colorado;

(c) The address of all offices or stores, if any, in Colorado at which rental purchase agreements are made;

(d) If rental purchase agreements are made in a place other than an office or store in Colorado, a brief description of the place and manner in which they are made; and

(e) The address of the registered agent upon whom service of process may be made in Colorado.

(3) If information in a notification becomes inaccurate after filing, no further notification is required until the lessor is required to file a subsequent notification pursuant to subsection (1) of this section.

Source: L. 90: Entire article added, p. 376, § 1, effective January 1, 1991.

5-10-805. Fees. (1) A lessor required to file a notification with the administrator under section 5-10-804 shall pay to the administrator the following fees:

(a) Fifty dollars for each address listed in section 5-10-804 (2) (c) paid at the time of the filing of the initial notification with the administrator;

(b) Twenty-five dollars for each address listed in section 5-10-804 (2) (c) paid at the time of the filing of each annual notification subsequently filed with the administrator.

(2) In addition to the fees required under subsection (1) of this section, if the administrator examines the books and records of the lessor, the lessor shall pay to the administrator a fee of two hundred dollars for each day required for the administrator or the administrator's representative to conduct the examination. However, the sum of all fees collected from a lessor under this subsection (2) may not exceed one thousand dollars in any calendar year.

(3) Notwithstanding the amount specified for any fee in this section, the administrator by rule or as otherwise provided by law may reduce the amount of one or more of the fees if necessary pursuant to section 24-75-402 (3), C.R.S., to reduce the uncommitted reserves of the fund to which all or any portion of one or more of the fees is credited. After the uncommitted reserves of the fund are sufficiently reduced, the administrator by rule or as otherwise provided by law may increase the amount of one or more of the fees as provided in section 24-75-402 (4), C.R.S.

Source: L. 90: Entire article added, p. 376, § 1, effective January 1, 1991. **L. 98:** (3) added, p. 1320, § 12, effective June 1.

PART 9

VIOLATIONS AND PENALTIES

5-10-901. Unlawful acts - fines - deceptive trade practice. (1) Any person who willfully and intentionally violates any provision of this article shall be guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine not to exceed five hundred dollars.

(2) Any intentional violation of the provisions of this article shall constitute a deceptive trade practice and shall be subject to the provisions of article 1 of title 6, C.R.S.

Source: L. 90: Entire article added, p. 376, § 1, effective January 1, 1991.

5-10-902. Remedies of lessee. (1) In case of a violation by a lessor of any provision of this article with respect to any rental purchase agreement, the lessee in such agreement may bring a suit in any court of competent jurisdiction to recover from such lessor or may set off or counterclaim in any action by such lessor actual damages. If the court finds that any such violation has occurred, it shall award a minimum recovery of two hundred fifty dollars or twenty-five percent of the total cost to acquire ownership under the rental purchase agreement, whichever is greater.

(2) The remedies specified in subsection (1) of this section are in addition to, and not in limitation of, any other remedies provided by law.

(3) In any action brought pursuant to this section, the court shall award the prevailing party the costs of the action and a reasonable attorney fee.

Source: L. 90: Entire article added, p. 377, § 1, effective January 1, 1991.

5-10-903. Unconscionability. (1) With respect to a rental purchase transaction, if the court as a matter of law finds the transaction, the agreement, or any clause of the agreement to have been unconscionable at the time it was made, the court may refuse to enforce the agreement or it may enforce the remainder of the agreement without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) If it is claimed or appears to the court that the transaction, the agreement, or any clause thereof may be unconscionable, the parties shall be afforded a reasonable opportunity to present evidence as to its setting, purpose, and effect to aid the court in making any such determination related to unconscionability.

(3) If, in an action in which unconscionability is claimed, the court finds unconscionability pursuant to this section, the court may award the costs of the action and a reasonable attorney fee to the lessee. If the court does not find unconscionability and does find that the lessee claiming unconscionability brought or maintained an action he knew to be groundless, the court may award the costs of the action and a reasonable attorney fee to the party against whom the claim was made. In determining such attorney fee, the amount of recovery claimed on behalf of the lessee shall not be controlling.

(4) The remedies of this section are in addition to remedies otherwise available for the same conduct authorized under law other than in this article, but double recovery of actual damages may not be had.

(5) For the purpose of this section, a charge or practice expressly permitted by this article is not in itself unconscionable.

Source: L. 90: Entire article added, p. 377, § 1, effective January 1, 1991.

5-10-904. Effect of correction. Notwithstanding sections 5-10-801 and 5-10-902, any failure to comply with any provisions of this article resulting from a bona fide or clerical error may be corrected by the lessor within sixty days after discovering an error and prior to the institution of any action under this article, or within sixty days of the receipt of written notice of the error after the date of execution of the rental purchase agreement by the lessee. If so corrected, neither the lessor nor any holder is subject to penalty under this section. A copy of any rental purchase agreement to which such a correction is made shall be promptly sent to the lessee.

Source: L. 90: Entire article added, p. 377, § 1, effective January 1, 1991.

5-10-905. Statute of limitations. No action shall be brought by a lessee under this article more than three years after the lessee knew or should have known of the occurrence of the alleged violation. This section does not bar a person from asserting a violation of this article in any action to collect the debt which was brought more than three years from the date of the occurrence of the violation as a matter of defense by recoupment or setoff in such action.

Source: L. 90: Entire article added, p. 378, § 1, effective January 1, 1991.

Cross references: For statutes of limitations generally, see article 80 of title 13.

PART 10

ADVERTISING

5-10-1001. Advertising. (1) An advertisement for a rental purchase agreement shall not state or imply that a specific item is available at specific amounts or terms unless the lessor usually and customarily offers or will offer that item at those amounts or terms.

(2) If any advertisement for a rental purchase agreement refers to or states the amount of any payment or the right to acquire ownership for a specific item, the advertisement must also clearly and conspicuously state the following terms as applicable:

(a) That the transaction is a rental purchase agreement or rent-to-own agreement;

(b) The total number of payments and amount of such payments necessary to acquire ownership; and

(c) That the lessee will not own the property until the total of such payments is paid in full or is paid by prepayment.

(3) Advertising which complies with the "Federal Consumer Credit Protection Act" does not violate this section.

(4) With the exception of the lessor, this section imposes no liability on the owner or personnel of any medium in which an advertisement appears or through which it is disseminated.

Source: L. 90: Entire article added, p. 378, § 1, effective January 1, 1991.

INTEREST RATES

ARTICLE 12

Interest - General Provisions

Editor's note: This title was repealed and reenacted in 1971. This article was numbered as article 12 of chapter 73, C.R.S. 1963. For historical information concerning the repeal and reenactment of this title in 1971, see the editor's note immediately following the title heading for this title.

5-12-101. Legal rate of interest. If there is no agreement or provision of law for a different rate, the interest on money shall be at the rate of eight percent per annum, compounded annually.

Source: L. 71: R&RE, p. 852, § 1. **C.R.S. 1963:** § 73-12-101. **L. 75:** Entire section amended, p. 257, § 1, effective July 1. **L. 79:** Entire section amended, p. 315, § 1, effective June 20.

Cross references: For interest on damages for personal injuries, see § 13-21-101.

COLORADO COMMENT

The provisions of this Article 12 are derived in part from Article 1 of Chapter 73, C.R.S. 1963, in effect prior to this Code.

ANNOTATION

Law reviews. For article, "Notice to Attorneys", see 12 Dicta 196 (1935). For article, "A Decade of Colorado Law: Conflict of Laws, Security, "Colorado Interest Law", see 34 Dicta 398 (1957). For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For article, "Collecting Pre- and Post-Judgment Interest in Colorado: A Primer", see 15 Colo. Law. 753 (1986). For article, "An Update of Appendices from Collecting Pre- and Post-Judgment Interest in Colorado", see 15 Colo. Law. 990 (1986). For article, "Recovery of Interest: Parts I and II", see 18 Colo. Law. 1063 and 1307 (1989).

Annotator's note. Since § 5-12-101 is similar to repealed § 73-1-1, C.R.S. 1963, CSA, C. 88, § 1, and laws antecedent to CSA, C. 88, § 1, relevant cases construing those provisions have been included in the annotations to this section.

Change in legal rate does not affect preexisting contracts. Salazar v. Taylor, 18 Colo.

538, 33 P. 369 (1893); Bankers Trust Co. v. Int'l. Trust Co., 108 Colo. 15, 113 P.2d 656 (1941).

Interest awarded. M.L.G. Corp. v. Davis, 672 P.2d 1019 (Colo. App. 1983).

This section does not apply to a situation covered by the prompt payment statute. To the extent there is a conflict, the more specific prompt payment statute prevails over this section. New Design Constr. Co. v. Hamon Contractors, Inc., 215 P.3d 1163 (Colo. App. 2008).

Applied in Farmers State Bank v. Klein, 159 Colo. 165, 410 P.2d 632 (1966); Equal Emp. Opportunity Comm'n v. Safeway Stores, Inc., 634 F.2d 1273 (10th Cir. 1980); Martinez v. Continental Enterprises, 730 P.2d 308 (Colo. 1986); Hansen v. Lederman, 759 P.2d 810 (Colo. App. 1988); Colo. Springs v. Timberlane Assoc., 807 P.2d 1177 (Colo. App. 1990).

5-12-102. Statutory interest. (1) Except as provided in section 13-21-101, C.R.S., when there is no agreement as to the rate thereof, creditors shall receive interest as follows:

(a) When money or property has been wrongfully withheld, interest shall be an amount which fully recognizes the gain or benefit realized by the person withholding such money or property from the date of wrongful withholding to the date of payment or to the date judgment is entered, whichever first occurs; or, at the election of the claimant,

(b) Interest shall be at the rate of eight percent per annum compounded annually for all moneys or the value of all property after they are wrongfully withheld or after they become due to the date of payment or to the date judgment is entered, whichever first occurs.

(2) When there is no agreement as to the rate thereof, creditors shall be allowed to receive interest at the rate of eight percent per annum compounded annually for all moneys after they become due on any bill, bond, promissory note, or other instrument of writing, or money due on mutual settlement of accounts from the date of such settlement and on money due on account from the date when the same became due.

(3) Interest shall be allowed as provided in subsection (1) of this section even if the amount is unliquidated at the time of wrongful withholding or at the time when due.

(4) Except as provided in section 5-12-106, creditors shall be allowed to receive interest on any judgment recovered before any court authorized to enter the same within this state from the date of entering said judgment until satisfaction thereof is made either:

(a) At the rate specified in a contract or instrument in writing which provides for payment of interest at a specified rate until the obligation is paid; except that if the contract or instrument provides for a variable rate, at the rate in effect under the contract or instrument on the date judgment enters; or

(b) In all other cases where no rate is specified, at the rate of eight percent per annum compounded annually.

Source: L. 71: R&RE, p. 852, § 1. **C.R.S. 1963:** § 73-12-102. **L. 75:** Entire section amended, p. 257, § 2, effective July 1. **L. 79:** Entire section R&RE, p. 315, § 2, effective June 20. **L. 82:** (4) amended, p. 227, § 2, effective January 1, 1983. **L. 83:** (4) amended, p. 394, § 1, effective July 1. **L. 84:** (4)(a) amended, p. 286, § 1, effective July 1.

ANNOTATION

I. GENERAL CONSIDERATION.

Law reviews. For note, "Curious Origin of the Compound Interest Rule in Colorado", see 1 Rocky Mt. L. Rev. 148 (1929). For note, "Interest as Damages in Colorado", see 16 Rocky Mt. L. Rev. 162 (1944). For note, "Interest as Damages in Colorado", see 28 Dicta 285 (1951). For note, "Colorado Interest Law", see 34 Dicta 398 (1957). For article, "One Year Review of Contracts", see 36 Dicta 19 (1959). For article, "One Year Review of Contracts", see 37 Dicta 1 (1960). For article, "One Year Review of Contracts", see 39 Dicta 161 (1962).

For article, "A Creditor's Right to Interest in Colorado", see 35 U. Colo. L. Rev. 190 (1963). For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For article, "Rates of Interest on State and Federal Court Judgments: An Update", see 12 Colo. Law. 446 (1983). For article, "Colorado's Prejudgment Interest Statute: Potential for Market Rate Interest", see 12 Colo. Law. 1605 (1983). For article, "Collecting Pre- and Post-Judgment Interest in Colorado: A Primer", see 15 Colo. Law. 753 (1986). For article, "An Update of Appendices from Collecting Pre- and Post-Judgment Interest in Colorado", see 15 Colo. Law. 990 (1986). For article, "Let the Builder-Vendor Beware: Defenses and Damages in Home Builder Litigation — Part II", see 16 Colo. Law. 629 (1987). For article, "Recovery of Interest: Parts I and II", see 18 Colo. Law. 1063 and 1307 (1989). For article, "Prejudgment Interest for Wrongful Withholding in Constructive Trust Remedy Actions", see 23 Colo. Law. 351 (1994).

Annotator's note. Since § 5-12-102 is similar to repealed § 73-1-2, C.R.S. 1963, § 73-1-2, CRS 53, CSA, C. 88, § 2, and laws antecedent to CSA, C. 88, § 2, relevant cases construing those provisions have been included in the annotations to this section.

Interest is a compensation for the use of money for its detention. City of Denver v. Barber Asphalt Paving Co., 141 F. 69 (8th Cir. 1905).

Recovery of that compensation may be pursued as prejudgment interest in accordance with the terms of this section, or in circumstances in which statutory interest would not be available, it may be sought as moratory interest which recognizes interest as a part of compensatory damages. Scognamillo v. Olsen, 795 P.2d 1357 (Colo. App. 1990).

In historical perspective. The exaction or taking of interest or compensation for the use of money was regarded as usurious, whether moderate or excessive, both in biblical times and by the early common law prior to the reign of Henry VIII. It seems to have been held by the church that the taking of interest was actually sinful as against the laws of God and morality and by the courts that it was unlawful on the theory of the classical and medieval economists from the time of Aristotle that money was only a medium of exchange and naturally barren and unproductive. By the 16th century the gap between religious theory and commercial practice had been further narrowed, and the new protestant ethics regarded only excessive exactions as usury. In the United States, the courts have always viewed the allowance of interest with greater favor than have the courts in England. The English common law has never been suited to the conditions existing in this country, and the American courts have never doubted the right to interest where it has been expressly contracted for, or where an undertaking to pay interest may be implied from the usages of trade. Stone v. Currigan, 138 Colo. 442, 334 P.2d 740 (1959).

In Colorado. Interest having become recognized as lawful and just compensation for the use of money rightfully belonging to another, the first session of the general assembly of the territory of Colorado adopted an interest statute, which, with only slight changes, now appears as § 5-12-102. Stone v. Currigan, 138 Colo. 442, 334 P.2d 740 (1959).

Hence, interest is a creature of statute. Hendrie v. Bd. of County Comm'rs, 153 Colo. 432, 387 P.2d 266 (1963).

Where no agreement. Interest, when there is no agreement therefor, is a matter of statute. In re Estate of Granberry, 30 Colo. App. 590, 498 P.2d 960 (1972).

The right to interest, absent an independent agreement, is statutory and is limited to those circumstances enumerated in the statute. Messler v. Phillips, 867 P.2d 128 (Colo. App. 1993); Indian Mountain Metro. Recreation & Park Dist. v. J.P. Campbell & Assocs., 921 P.2d 65 (Colo. App. 1996); Bd. of County Comm'rs of Dolores County v. Shell Western E & P, Inc., 12 P.3d 1219 (Colo. App. 2000).

Where there is no "judgment" entered in a "court" to which subsection (4) could apply, a claim for post-judgment interest pursuant to subsection (4) is properly rejected. Bd. of County Comm'rs of Dolores County v. Shell Western E & P, Inc., 12 P.3d 1219 (Colo. App. 2000).

Interest is the compensation allowed by law, or fixed by the parties, for the use, detention, or forbearance of money or its equivalent. Stone v. Currigan, 138 Colo. 442, 334 P.2d 740 (1959).

This section is intended to provide for award of interest from the time plaintiffs were wronged. Combined Com. Corp. v. Pub. Serv. Co., 865 P.2d 893 (Colo. App. 1993); Porter Constr. Servs. v. Ehrhardt, Keefe, Steiner, & Hottman, P.C., 131 P.3d 1115 (Colo. App. 2005).

Purpose of statutory interest is to discourage delaying payment of a claim. Mesa Sand & Gravel v. Landfill, Inc., 776 P.2d 362 (Colo. 1989); Michaelson v. Michaelson, 884 P.2d 695 (Colo. 1994); Stansbury v. Comm'r of Internal Rev., 102 F.3d 1088 (10th Cir. 1996); Scott v. Comm'r of Internal Rev., 236 F.3d 1239 (10th Cir. 2001); Ross v. Old Republic Ins. Co., 134 P.3d 505 (Colo. App. 2006), aff'd on other grounds, 180 P.3d 427 (Colo. 2008).

This section to be strictly construed. Isbill Associates, Inc. v. City & County of Denver, 666 P.2d 1117 (Colo. App. 1983); Mesa Sand & Gravel v. Landfill, Inc., 776 P.2d 362 (Colo. 1989); Michaelson v. Michaelson, 884 P.2d 695 (Colo. 1994).

The appellate court's authority to determine interest is exclusive. While the appellate court may, of course, remand to the trial court for a determination of the proper statutory interest, the trial court, without such an instruction, lacks jurisdiction to enter any amount of interest not stated in the mandate. Pet, Inc. v. Goldberg, 37 Colo. App. 257, 547 P.2d 943 (1975).

Law of the forum governs. Colorado follows a minority rule of conflict of laws in determining what law applies to interest questions, and Colorado holds that it is the law of the forum which governs. Davis Cattle Co. v. Great W. Sugar Co., 393 F. Supp. 1165 (D. Colo. 1975), aff'd, 544 F.2d 436 (10th Cir. 1976), cert. denied, 429 U.S. 1094, 97 S. Ct. 1109, 51 L. Ed. 541 (1977).

The question of entitlement to interest is to be answered under Colorado law, even as to parties who are citizens of other states and whose farms are in other states. Davis Cattle Co. v. Great W. Sugar Co., 393 F. Supp. 1165 (D. Colo. 1975), aff'd, 544 F.2d 436 (10th Cir. 1976), cert. denied, 429 U.S. 1094, 97 S. Ct. 1109, 51 L. Ed. 2d 541 (1977).

The proper method of attacking an appellate court's instructions as to interest is to petition for amendment or recall of the mandate. Such a procedure is available in Colorado. Pet, Inc. v. Goldberg, 37 Colo. App. 257, 547 P.2d 943 (1975).

Relationship of section to C.A.R. 37. While this section states the circumstances wherein interest shall be allowed to a creditor or on a judgment, C.A.R. 37 requires and empowers the appellate court to make the determination of interest to be allowed, if any, and to include instructions concerning the entry of such interest in its mandate when a judgment is modified or reversed with directions for entry of a money judgment. Pet, Inc. v. Goldberg, 37 Colo. App. 257, 547 P.2d 943 (1975).

No conflict with § 38-1-116. There is no conflict between § 38-1-116, which provides for six percent interest in an eminent domain proceeding from the date of possession until the date the commission's award is filed with the court, and this section, pertaining to interest thereafter, since once the amount of the valuation award has been ascertained by the commission, the result is like any other judgment. Denver Urban Renewal Auth. v. Hayutin, 40 Colo. App. 559, 583 P.2d 296 (1978).

Interest questions in a suit on a contract brought in federal court are to be determined by state law, whether jurisdiction is founded on a federal question or diversity of citizenship. Rocky Mt. Tool & Mach. Co. v. Tecon Corp., 371 F.2d 589 (10th Cir. 1966).

This section affects rate of interest held not to be paid on the redemption of land. O'Mahoney v. People ex rel. Stone, 24 Colo. 524, 52 P. 796 (1898).

This section does not apply to the collection of interest on overdue taxes because there must be an agreement expressing mutuality of contract before this section applies, and a contractual relationship clearly is not involved in a claim for overdue taxes. State Farm Mut. Auto. Ins. Co. v. Temple, 176 Colo. 537, 491 P.2d 1371 (1971).

For the "unreasonable and vexatious delay in payment" clause contained in earlier provision, see Craig v. Chandler, 6 Colo. 543 (1883); Corson v. Neatheny, 9 Colo. 212, 11 P. 82 (1886); Keys v. Morrison, 3 Colo. App. 441, 34 P. 259 (1893); Young v. Kimber, 44 Colo. 448, 98 P. 1132, 28 L.R.A. 626 (1909).

This section allows pre-judgment interest on a judgment against the state because nothing in this section precludes such interest. Plaintiff, a public officer, was, therefore, entitled to pre-judgment interest on the underpaid portion of his accumulated vacation leave. Wilkerson v. State, 830 P.2d 1121 (Colo. App. 1992).

Awarding interest is compensation for actual, pecuniary damage suffered by the victim incidental to the defendant's crime of fraudulently obtaining funds because the victim loses the use of the money involved. Interest is awarded as restitution to compensate the victim for such loss of use, it is not intended to reimburse the victim for interest that otherwise would have been earned on the funds. Valenzuela v. People, 893 P.2d 97 (Colo. 1995).

An insurer is liable for prejudgment interest pursuant to this section for underinsured motorist coverage from the date of the insurer's wrongful refusal or failure to pay, notwithstanding a policy provision that provided that liability and the amount of damages were to be determined by agreement of the parties or by arbitration. Bowen v. Farmers Ins. Exch., 929 P.2d 14 (Colo. App. 1996).

This section governs award of prejudgment interest in non-personal injury cases only. Liability of insurer in personal-injury case is normally governed by § 13-21-101 and case law under that section treating prejudgment interest as an element of compensatory damages, subject to limitations on coverage stated in policy. Award of prejudgment interest under this section is not appropriate unless insurer breached its contract with insured or otherwise wrongfully withheld amounts due. Old Republic Ins. Co. v. Ross, 180 P.3d 427 (Colo. 2008).

Plaintiff is entitled to recover prejudgment interest from date of injury until issuance of initial arbitration award but only to the limits of the uninsured motorist policy. Swan v. Am. Family Mut. Ins. Co., 8 P.3d 546 (Colo. App. 2000).

Applied in Big O Tire Dealers, Inc. v. Goodyear Tire & Rubber Co., 408 F. Supp. 1219 (D. Colo. 1976); Alexander Dawson, Inc. v. Sage Creek Canyon Co., 37 Colo. App. 339, 546 P.2d

969 (1976); Weather Eng'r & Mfg., Inc. v. Pinon Springs Condominiums, Inc., 192 Colo. 495, 563 P.2d 346 (1977); Gundelach v. Gollehon, 42 Colo. App. 437, 598 P.2d 521 (1979); A-1 Plumbing & Heating Co. v. Thirteenth St. Corp., 44 Colo. App. 13, 616 P.2d 141 (Colo. App. 1980); M & T, Inc. v. Fuel Res. Dev. Co., 518 F. Supp. 285 (D. Colo. 1981); In re Lucas, 631 P.2d 1175 (Colo. App. 1981); Surplus Elecs. Corp. v. Gallin, 653 P.2d 752 (Colo. App. 1982); Acme Delivery Serv., Inc. v. Samsonite Corp., 663 P.2d 621 (Colo. 1983); E. Larimer County Water v. Centric Corp., 693 P.2d 1019 (Colo. App. 1984); Weston v. Mincomp Corp., 698 P.2d 274 (Colo. App. 1985); Autocon Indus., Inc. v. W. States Constr. Co., Inc., 728 P.2d 374 (Colo. App. 1986); Nat'l Sur. Corp. v. Citizens State Bank, 734 P.2d 663 (Colo. App. 1986); Recreational Dev. Co. v. Am. Const., 749 P.2d 1002 (Colo. App. 1987); Britvar v. Schainuck, 791 P.2d 1183 (Colo. App. 1989); Arguelles v. Ridgeway, 827 P.2d 553 (Colo. App. 1991); Flexisystems, Inc. v. Am. Standards Testing Bureau, Inc., 847 P.2d 207 (Colo. App. 1992); Smith v. Mehaffy, 30 P.3d 727 (Colo. App. 2000); Atmel Corp. v. Vitesse Semiconductor Corp., 160 P.3d 347 (Colo. App. 2007).

II. ALLOWANCE OF INTEREST.

A. In General.

The right to interest, independent of an agreement to pay it, is statutory. Weaver v. First Nat'l Bank, 138 Colo. 83, 330 P.2d 142 (1958); York Plumbing & Heating Co. v. Groussman Inv. Co., 166 Colo. 382, 443 P.2d 986 (1968).

The subject of interest is governed by statute, and in no case where interest is not so provided is it recoverable, unless specially contracted for, except in the nature of damages, where a refusal to pay has been wilful, wrongful, fraudulent, or without reasonable cause. Since this section points out in detail and especially enumerates the cases in which interest is allowable, assuming to cover the whole field, it is not recoverable in any case not thus expressly enumerated, or included by fair implication. When the general assembly assumed to declare in what cases interest could be allowed, under the rule that the expression of the one is the exclusion of another, no interest can be allowed in any case not specified. Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1914).

The right to interest, independent of an agreement to pay it, is statutory; it is not given by the common law. However, there has always been a statute providing for interest, enumerating the cases in which it might be allowed and this section is substantially the same as the older statutes. Greeley, S. L. & Pac. Ry. v. Yount, 7 Colo. App. 189, 42 P. 1023 (1895); Bd. of Comm'rs v. Wheeler, 39 Colo. 207, 89 P. 50 (1907); Bankers Trust Co. v. Int'l Trust Co., 108 Colo. 15, 113 P.2d 656 (1941).

In the absence of agreement, interest can be recovered only in the cases mentioned in this section. Keys v. Morrison, 3 Colo. App. 441, 34 P. 259 (1893); Hanauer v. Bartels, 2 Colo. 514 (1875); Greeley, S. L. & Pac. Ry. v. Yount, 7 Colo. App. 189, 42 P. 1023 (1895), distinguishing Machette v. Wanless, 2 Colo. 169 (1873); Omaha & Grant Smelting amp; Ref. Co. v. Tabor, 13 Colo. 41, 21 P. 925(1889)(recovery allowed as damages and not as interest, the legal rate of interest being merely used as a convenient way of arriving at their amount); Morris v. Redak, 124 Colo. 27, 234 P.2d 908 (1951); Mitton v. Granite State Fire Ins. Co., 196 F.2d 988 (10th Cir. 1952); Hunter v. Wilson, 147 Colo. 36, 362 P.2d 553 (1961).

In the absence of any contractual provision, prejudgment interest can only be recovered in the cases enumerated in this section. Denver Ass'n for Retarded Children v. Sch. Dist. No. 1, 188 Colo. 310, 535 P.2d 200 (1975).

This section enumerates the cases in which interest may be awarded. Weaver v. First Nat'l Bank, 138 Colo. 83, 330 P.2d 142 (1958).

This section allows interest on money which is due and owing, regardless of whether the money was wrongfully withheld. In re Tri Sys. Consulting & Design, Inc., 115 Bankr. 279 (Bankr. D. Colo. 1990).

The right to recover interest is purely a legal one, and in no sense an equitable right. Denver, S. P. & P. R. R. v. Conway, 8 Colo. 1, 5 P. 142 (1884); DeRemer v. Parker, 19 Colo. 242, 34 P. 980 (1893); Pettit v. Thalheimer, 3 Colo. App. 355, 33 P. 277 (1893); Patten v. Am. Nat'l Bank, 15 Colo. App. 479, 63 P. 424 (1900).

1979 amendment applicable to judgments entered after effective date. Subsection (1)(a), which became effective July 1, 1979, applies to any judgments entered after that date, even where the withholding of the property in question was prior to the effective date of the amendment. Great W. Sugar Co. v. N. Natural Gas Co., 661 P.2d 684 (Colo. App. 1982), aff'd sub nom. KN Energy, Inc. v. Great W. Sugar, Co., 698 P.2d 769 (Colo. 1985), cert. denied, 472 U.S. 1022, 105 S. Ct. 3489, 87 L. Ed. 2d 623 (1985).

The intent of subsection (1)(a) was to correct the situation in which a wrongdoer would stall settlement or judgment in order to reap the benefit of having use of money or property which was producing more profit for him than the statutory interest rate he would eventually have to pay. Any benefit resulting from the wrongful withholding was intended to be enjoyed not by the wrongdoer, but by the injured party. Great W. Sugar Co. v. KN Energy, Inc., 778 P.2d 272 (Colo. App. 1989).

Section requires an award of prejudgment interest in a rescission action, regardless of

whether the issue was raised at trial or evidence was presented on the issue. Kennedy v. Gillam Dev. Corp., 80 P.3d 927 (Colo. App. 2003).

Prejudgment and postjudgment interest should have been awarded in homeowner's successful action against tenants for past-due rent and damage to premises. Butler v. Lembeck, 182 P.3d 1185 (Colo. App. 2007).

A wrongful withholding need not involve actual fraud or be tortious in nature. Section 38-10-117 provides that any conveyance made with the intent to hinder, delay, or defraud creditors is fraudulent. Stansbury v. Comm'r of Internal Rev., 102 F.3d 1088 (10th Cir. 1996).

Corporate executive of insolvent company liable as a transferee of assets for unpaid income taxes and the interest that accrued since the taxes became due. Transferee liable under § 38-10-117 (1) because conveyance was made with the intent to hinder, delay, or defraud creditors, in this case, the internal revenue service. While structuring the sale of the assets of the insolvent company, corporate executive (transferee) obtained multiple opinions on the foreseeable tax consequences. Informed by those opinions and his corporate acumen, executive knowingly chose to take a calculated risk. Scott v. Comm'r of Internal Rev., 236 F.3d 1239 (10th Cir. 2001).

A wrongful withholding only requires the failure to pay or deliver money or property when there is an obligation to do so. Therefore an insurer's failure to pay uninsured motorist benefits need not be tortious or in bad faith to be a wrongful withholding for purposes of this section. Peterman v. State Farm Mut. Auto. Ins. Co., 8 P.3d 549 (Colo. App. 2000).

There are judicially created exceptions to the general rule that the allowance of interest is a creature of statute. Davis Cattle Co. v. Great W. Sugar Co., 544 F.2d 436 (10th Cir. 1976), cert. denied, 429 U.S. 1094, 97 S. Ct. 1109, 51 L. Ed. 2d 541 (1977).

A plaintiff is not entitled to prejudgment interest on all compensatory damages flowing from a wrongful withholding of property. Rather, a proper award of prejudgment interest applies only to that part of the compensatory damages awarded for money or property wrongfully withheld. Dillen v. HealthOne, L.L.C., 108, P.3d 297 (Colo. App. 2004).

Prejudgment interest under subsection (1) is recoverable in an insurer's equitable contribution action under former § 10-4-707 (3) of the Colorado no-fault insurance act. Safeco Ins. Co. v. Westport Ins. Corp., 214 P.3d 1078 (Colo. App. 2009).

Moratory interest. As a matter of state law, Colorado recognizes moratory interest or the allowance of interest as damages. Moratory interest has been allowed in Colorado for more than 100 years. Davis Cattle Co. v. Great W. Sugar Co., 393 F. Supp. 1165 (D. Colo. 1975), aff'd, 544 F.2d 436 (10th Cir. 1976), cert. denied, 429 U.S. 1094, 97 S. Ct. 1109, 51 L. Ed. 2d 541 (1977).

Under Colorado law statutory interest cannot be awarded on an unliquidated claim but such does not preclude the awarding of moratory interest, i.e., interest by way of damages and not as a creature of statute. Davis Cattle Co. v. Great W. Sugar Co., 544 F.2d 436 (10th Cir. 1976), cert. denied, 429 U.S. 1094, 97 S. Ct. 1109, 511 L. Ed. 2d 541 (1977).

In allowing prejudgment interest, it is recognized that just compensation for the victim is a fundamental principle of damages, and that where money has been wrongfully withheld, it is only fair that the victim receive interest on the money thus withheld. Davis Cattle Co. v. Great W. Sugar Co., 544 F.2d 436 (10th Cir. 1976), cert. denied, 429 U.S. 1094, 97 S. Ct. 1109, 51 L. Ed. 2d 541 (1977); Robb v. Universal Constructors, Inc., 665 F.2d 998 (10th Cir. 1981).

A judgment awarding interest on damages when entered falls under this section, and as to the statutory rate. The rate of statutory interest, as distinguished from the rate of moratory interest, is fixed and mandatory. Davis Cattle Co. v. Great W. Sugar Co., 393 F. Supp. 1165 (D. Colo. 1975), aff'd, 544 F.2d 436 (10th Cir. 1976), cert. denied, 429 U.S. 1094, 975 S. Ct. 1109, 51 L. Ed. 2d 541 (1977).

In the absence of any proof as to the guilty party's gain, the statutory rate of interest for transactions entered into at that time should be awarded as damages. Alfred Brown Co. v. Johnson-Gibbons and Reed, 695 P.2d 746 (Colo. App. 1984).

The court does not err when it awards interest on a wrongfully withheld sum even though the exact amount is unliquidated until the date of judgment. Jasken v. Sheehy Constr. Co., 642 P.2d 58 (Colo. App. 1982).

Interest award on spouse's elective share of augmented estate and exempt property allowance is one of moratory interest which may run from date court finds elective share and allowance rather than from date of death of spouse. Matter of Estate of Smith, 718 P.2d 1069 (Colo. App. 1986).

For discussion of moratory interest award, see E.B. Jones Constr. Co. v. Denver, 717 P.2d 1009 (Colo. App. 1986).

Buyer entitled to interest where bank failed to deliver to the buyers a warranty deed as required by the contract, and trial court properly found that the bank wrongfully withheld the property. Cooper v. Peoples Bank & Trust Co., 725 P.2d 78 (Colo. App. 1986).

Trial court acted properly in finding that the defendants had wrongfully withheld funds from plaintiffs and in awarding such plaintiffs prejudgment interest. Colo. Performance v. Mariposa Assoc., 754 P.2d 401 (Colo. App. 1987).

A claim for damages for lost market value stemming from stock not being registered together with interest measured by a percentage of that loss would have been one for prejudgment interest subject to the limitations of Colorado law. United Telecomms., Inc. v. Am. Television & Commc'ns Corp., 536 F.2d 1310 (10th Cir. 1976).

The Colorado interest statute does not deal with interest charges which arise from an independent debt owed by the plaintiff to a third party. United Telecomms., Inc. v. Am. Television & Commc'ns Corp., 536 F.2d 1310 (10th Cir. 1976).

Interest which appellant was obligated to pay on money which it was required to borrow as a result of appellee's unwarranted delays and manipulations is not regulated by this section. United Telecomms., Inc. v. Am. Television & Commc'ns Corp., 536 F.2d 1310 (10th Cir. 1976).

Brokerage commission due under oral contract falls within this section and interest is due on the commission from the date that it was due and payable. Hayes v. N. Table Mt. Corp., 43 Colo. App. 467, 608 P.2d 830 (1979).

Broker's commission became due as a matter of law when the broker produced a buyer ready, willing, and able to purchase the property, and interest at the statutory rate began to accrue at that time. Mack v. McKanna, 687 P.2d 1326 (Colo. App. 1984).

Interest from date of filing of complaint. Where all of the transactions involving the secret profit made by the real estate agent in sale of building in violation of agent's fiduciary duty were completed on December 18, 1972, the principal would have been entitled to interest at the legal rate on the judgment from that date. However, since in the complaint the principal asked for interest only from the date of filing the complaint, interest from that period shall be part of the judgment. Lestoque v. M.R. Mansfield Realty, Inc., 36 Colo. App. 32, 536 P.2d 1146 (1975).

A debtor cannot avoid the payment of interest by disputing an account, and when the account or any portion thereof is found due, the creditor is entitled to interest on the amount due. Quad Constr., Inc. v. Wm. A. Smith Contracting Co., 534 F.2d 1391 (10th Cir. 1976).

Award of prejudgment interest appropriate where money was wrongfully withheld pursuant to a statute which conflicted with the constitutional provision of article XXI, section 4. Passarelli v. Schoettler, 742 P.2d 867 (Colo. 1987).

An award of prejudgment interest in a judgment against the state is not prohibited even though the general assembly did not expressly provide for an award nor is governmental immunity a bar to such an award. Passarelli v. Schoettler, 742 P.2d 867 (Colo. 1987).

Prejudgment interest may be awarded in property damage cases, as the legislative history clearly indicates that all cases are to be treated equally regarding the time that interest begins to accrue. Isbill Assocs. v. City & County of Denver, 666 P.2d 1117 (Colo. App. 1983); La Fond v. Basham, 683 P.2d 367 (Colo. App. 1984); Mesa Sand & Gravel v. Landfill, Inc., 776 P.2d 362 (Colo. 1989); Lowell Staats Min. Co. v. Pioneer Uravan, Inc., 878 F.2d 1259 (10th Cir. 1989); Teilhaber Mfg. v. Unarco Materials, 791 P.2d 1164 (Colo. App. 1989).

Prejudgment interest may be awarded in breach of construction contract case even if amount is unliquidated at time of wrongful withholding. Hott v. Tillotson-Lewis Const. Co., 682 P.2d 1220 (Colo. App. 1983); Teilhaber Mfg. v. Unarco Materials, 791 P.2d 1164 (Colo. App. 1989); cert. denied, 803 P.2d 517 (Colo. 1991).

Prejudgment interest may be awarded in intentional interference with contract case, as subsection (1)(b) is to be given a broad liberal construction to effectuate the general assembly's purpose of compensating parties for the loss of money or property to which they are entitled. Westfield Dev. v. Rifle Inv. Assoc., 786 P.2d 1112 (Colo. 1990).

Prejudgment interest is permitted on the amount of compensatory damages that an insured would have received under the insurance contract from the time of the insurer's wrongful withholding. Herod v. Colo. Farm Bureau Mut. Ins., 928 P.2d 834 (Colo. App. 1996).

Prejudgment interest is permitted on the amount of wages for "comp time" employee earned while working for employer. Because employee was not paid those wages when he or she left the company, employer's withholding was wrongful. Thus, employee is entitled to an award of prejudgment interest calculated on his or her award from the effective date of resignation to the date of final judgment. Remote Switch Sys. v. Delangis, 126 P.3d 269 (Colo. App. 2005).

Nothing in the statute requires that a judgment creditor establish tortious conduct by a debtor to support award of prejudgment interest. Benham v. Mfrs. Wholesalers Indem. Exch., 685 P.2d 249 (Colo. App. 1984); Cooper v. Peoples Bank and Trust Co., 725 P.2d 78 (Colo. App. 1986).

Being the more specific statute, the plain terms of § 8-41-203 control over this section and, therefore, insurer is limited pursuant to subrogation agreement for workers' compensation to recover only the amount which it paid to the injured employee and cannot collect any interest on amount. Husson v. Meeker, 812 P.2d 731 (Colo. App. 1991).

This section contains no requirement that town request statutory interest in its pleadings for court to award interest pursuant to

C.R.C.P. 54(c). Town of Breckenridge v. Golforce, Inc., 851 P.2d 214 (Colo. App. 1992).

But, plaintiff not entitled to prejudgment interest in case of award of damages for emotional distress. Purpose of prejudgment interest is to discourage a person responsible for payment of a claim from delaying payment until judgment or settlement. Award of emotional distress damages are not intended to compensate for wrongful delay in obtaining money or property. Allabashi v. Lincoln Nat'l Sales Corp., 824 P.2d 1 (Colo. App. 1990).

Injuries properly determined as "personal" and not "property" in case where toxic contamination to property caused homeowners inconvenience and loss of peace of mind based on their fear that contaminants could be present in portions of their homes and the perceived stigma attached to homes in the neighborhood. Therefore, the trial court was correct in awarding prejudgment interest on damages at the rate allowed for cases involving "personal injuries". Antolovich v. Brown Group Retail, Inc., 183 P.3d 582 (Colo. App. 2007).

Trial court erred in awarding post-judgment interest to accrue at 8% per annum when promissory note provided for interest to accrue at 13% per annum until paid in full. Dikeou v. Dikeou, 916 P.2d 601 (Colo. App. 1995), rev'd on other grounds, 928 P.2d 1286 (Colo. 1996).

Trial court erred in denying plaintiff an award of prejudgment interest on disputed portion of settlement funds that had been placed in a money market account pending the outcome of the trial. Fasing v. LaFond, 944 P.2d 608 (Colo. App. 1997).

Creditor defendant entitled to post-judgment interest during its appeal under subsection (4). Post-judgment interest continues to accrue until the judgment is satisfied. Indian Mountain v. J.P. Campbell & Assocs., 921 P.2d 65 (Colo. App. 1996).

The inquiry under this section is whether the money or property was wrongfully withheld from the nonbreaching party, and not whether the nature of the conduct of the breaching party brings him or her within the ambit of the statute. Rodgers v. Colo. Dept. of Human Servs., 39 P.3d 1232 (Colo. App. 2001).

Where one party withholds money from another party in reliance on an administrative order that is subsequently reversed, the party withholding the money was not entitled to the money; therefore, the party that was deprived of the use of the money is entitled to an award of interest on the amount of money that was wrongfully withheld. Rodgers v. Colo. Dept. of Human Servs., 39 P.3d 1232 (Colo. App. 2001).

B. Bonds.

Interest upon the penalty of a bond is allowed, and the penalty in a bond is the amount which the obligors agree to pay, if the whole penalty be needed to satisfy the damages sustained by the obligee by a breach of the bond, and is due as soon as the breach occurs. Massachusetts Bonding & Ins. Co. v. State ex rel. Mallin, 141 Colo. 259, 347 P.2d 507 (1959).

An amount becomes due on a performance bond when the bills for costs are submitted to the surety. A dispute as to the amount due does not remove the claim from this section. Asphalt Paving Co. v. United States Fid. & Guar. Co., 671 P.2d 1013 (Colo. App. 1983).

The fact that the amount of the judgment, together with interest, exceeds the penalty of a bond does not preclude the collection of principal and interest. Massachusetts Bonding & Ins. Co. v. State ex rel. Mallin, 141 Colo. 259, 347 P.2d 507 (1959).

The fact that a judgment was not satisfied, in due course, and that, as a consequence, the amount of that judgment together with accrued interest now exceeds the penalty of a bond does not preclude the collection of principal and interest. Key Sav. & Loan Ass'n v. Travelers Indem. Co., 32 Colo. App. 358, 513 P.2d 737 (1973).

C. Promissory Notes.

Note may provide for payment of interest. Under this section a promissory note which provides that upon failure to pay the principal when due interest shall be payable from date of note is a good contract, and the interest is recoverable. McKay's Estate v. Belknap Sav. Bank, 27 Colo. 50, 59 P. 745 (1899).

Upon a guaranty indorsed on a promissory note, both the principal and the interest specified in the note may be recovered. Martin v. Hazzard Powder Co., 2 Colo. 596 (1875).

Only statutory rate of interest allowed. Where judgment is procured upon a note, only statutory interest as allowed by this section can be recovered, notwithstanding the note provides for higher interest on amounts not paid when due. Hiller v. Matheny, 81 Colo. 459, 256 P. 10 (1927).

In an action to recover the amount paid for notes where the purchase is rescinded for fraud, the basis of recovery is the benefit to the defendant, and where there is an absence of proof as to the interest rate which would produce an amount equal to such benefit the statutory legal rate should be adopted. Bankers Trust Co. v. Int'l Trust Co., 108 Colo. 15, 113 P.2d 656 (1941).

Where the rate of interest is left blank on a promissory note, the legal rate, as provided by this section, is six percent, and the insertion of a higher rate of interest by the holder constitutes a material alteration which renders the note invalid. Farmers State Bank v. Klein, 159 Colo. 165, 410 P.2d 632 (1966).

If the person executing a preprinted form note which provides a blank for interest does not want to be bound to such, then the provision should be stricken or the word "none" should be inserted in the blank; otherwise interest at the statutory rate is due. Fin. Mgmt. Task Force, Inc. v. Altberger, 807 P.2d 1230 (Colo. App. 1990).

D. Other Instruments of Writing.

The "other instrument of writing" as used in this section is one based on contractual relations, an instrument importing mutuality, one which implies an obligation to pay for a consideration rendered. Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1914).

A will is not such an instrument. Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1914).

Interest in a legacy is not allowable. Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1914).

The term "instrument of writing" has a definite legal meaning which excludes a verdict as something essentially different. Hawley v. Barker, 5 Colo. 118 (1879); Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1914).

An instrument of writing implies an agreement or contract which it contains and of which it is the memorial. Hawley v. Barker, 5 Colo. 118 (1879); Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1914).

This definition is in effect a declaration that such "other instrument of writing" must be one having the characteristics of a bond, bill, or promissory note and may not be something essentially different. Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1914).

A policy of insurance is a contract and is within the meaning of "other instrument of writing". Bloom v. Wolfe, 37 Colo. App. 407, 547 P.2d 934 (1976).

Coupons from municipal bonds, being issued by the municipality in its business, rather than its governmental function, are "promissory notes" or "other instruments of writing" within the meaning of this section and bear interest from their maturity as therein provided. Bd. of Comm'rs v. Geer, 108 F. 478 (8th Cir. 1901).

Where leased property is thrown into the hands of a receiver and the landlord directs the tenant to pay no rent to anyone, on which direction he so acts, this does not, under this section, relieve him from liability for interest on payments so withheld. Lamar Cold Storage Co. v. Union Ice & Storage Co., 77 Colo. 556, 238 P. 42 (1925).

E. Judgments.

A judgment creditor who has a claim which falls within the clearly expressed wording of this section is entitled to interest on such claim from the date and at the rate specified in the statute. Stone v. Currigan, 138 Colo. 442, 334 P.2d 740 (1959).

This section authorizes interest at the legal rate on the amount of a judgment from and after entry thereof. Denver-Albuquerque Motor Transp., Inc. v. Galligan, 145 Colo. 71, 358 P.2d 28 (1960).

Interest on a judgment is specifically authorized by this section. Security Ins. Co. v. Houser, 191 Colo. 189, 552 P.2d 308 (1976).

Pursuant to this section, interest is recoverable from the date the amount becomes due. Flight Sys. v. Elgood-Mayo Corp., 660 P.2d 909 (Colo. App. 1982).

Where the insurance contract does not specify a rate of interest, the general statutory rate of eight percent governs the recovery of postjudgment interest. Church v. Am. Standard Ins. Co., 764 P.2d 405 (Colo. App. 1988); Loza v. State Farm Mut. Auto. Ins. Co., 971 P.2d 251 (Colo. App. 1998).

Although an underinsured motorist policy is a contract and therefore would fall under this section, which dictates interest to accrue at eight percent, the claim under that policy may be premised upon a tort claim for bodily injury and therefore accrue interest at the higher rate dictated by § 13-21-101. Here, plaintiff's underinsured motorist claim was for damages resulting from the tort of another person, even though it also involved the contract with his insurer; therefore, he was entitled to the higher interest rate of § 13-21-101. Parker v. USAA, 216 P.3d 7 (Colo. App. 2007), aff'd, 200 P.3d 350 (Colo. 2009).

The postjudgment interest rate authorized by this section serves as the interest rate for judgments involving personal injury protection benefits. If the interest rate under § 10-4-708 were to serve as the prejudgment and the postjudgment interest rate, an inconsistency would exist between this section and § 10-4-708, which establishes the prejudgment interest rate in personal injury protection benefit cases. Loza v. State Farm Mut. Auto. Ins. Co., 971 P.2d 251 (Colo. App. 1998).

A trial court errs in awarding interest from the date of filing the complaint. Denver-Albuquerque Motor Transp., Inc. v. Galligan, 145 Colo. 71, 358 P.2d 28 (1960).

Allowing interest from date of arbitration award is not error. Columbine Valley Constr. Co. v. Bd. of Dirs., 626 P.2d 686 (Colo. 1981).

Interest accrues from the date of the wrong, not from the date of the judgment. Isbill Assocs., Inc. v. Denver, 666 P.2d 1117 (Colo. App. 1983); Bassett v. Eagle Telecomms., 750 P.2d 73 (Colo. App. 1987); Colo. Performance Corp. v. Mariposa Assocs., 754 P.2d 401 (Colo. App. 1987).

Interest on property damage award accrues from the time the cause of action accrued, that is, from the date on which the injured party was wronged. Federal Ins. Co. v. Ferrellgas, Inc., 961 P.2d 511 (Colo. App. 1997).

Interest on damage award in an ADA claim accrues from the date of judgment and not from the date of the jury verdict. Fail v. Cmty. Hosp., 946 P.2d 573 (Colo. App. 1997).

When attorney fees are awarded, not as damages but to shift the burden of litigation, interest on the award runs from the date of the final order quantifying the amount of fees and not from any earlier judgment or order that might have established a party's right to recover damages or fees without specifying an amount. Kennedy v. King Soopers Inc., 148 P.3d 385 (Colo. App. 2006).

Under this section fixing the rate of interest at six percent, a judgment fixing the rate of interest in such case higher is erroneous. Bd. of County Comm'rs v. Bd. of County Comm'rs, 15 Colo. 320, 25 P. 508 (1890).

After judgment is entered, this section is applicable in regard to collection of interest on judgment. Schoenfeld v. Neher, 453 F.2d 896 (10th Cir. 1972).

Insurer cannot owe postjudgment interest in absence of an enforceable judgment. Old Republic Ins. Co. v. Ross, 180 P.3d 427 (Colo. 2008).

A plaintiff on the entry of a judgment becomes a creditor as contemplated by this section; he becomes a judgment creditor and clearly comes within the statutory purview of those entitled to recover interest. Stone v. Currigan, 138 Colo. 442, 334 P.2d 740 (1959).

Where a judgment is entered "nunc pro tunc", plaintiff should have interest on the amount to be found due as of the date it is considered reduced to judgment since, except as to the rights of third persons, a judgment "nunc pro tunc" is retrospective and has the same force and effect, to all intents and purposes, as though it had been entered at the time when the judgment was originally rendered. Stone v. Currigan, 138 Colo. 442, 334 P.2d 740 (1959).

Similarly, where the court orders claims to be restored "with legal interest", such claims duly allowed are of like significance, and bear the same interest as entered judgments under this section. Myers v. Colo. Pulp & Paper Co., 95 Colo. 328, 35 P.2d 1020 (1934).

A verdict for the full amount due under a contract of sale is tantamount to a determination that plaintiffs substantially complied with the terms of the contract, and that the sums provided therein became due and payable according to its tenor; this being so, they are entitled to statutory interest after maturity. Baer Bros. Land & Cattle Co. v. Reed, 197 F.2d 569 (10th Cir. 1952).

Where a motion for a new trial is overruled and thereafter a trial court computes interest on the verdict and orders judgment in the amount of the verdict and interest, this concludes the trial court's action relative to the judgment, and it becomes the final judgment. Green v. Jones, 134 Colo. 208, 304 P.2d 901 (1956).

In a suit on a foreign judgment, it is proper to allow interest on the original judgment and make the sum of principal and interest the principal amount of the judgment, which will also draw interest. Bruckman v. Taussig, 7 Colo. 561, 5 P. 152 (1884).

Judgment awarding prejudgment interest is not final until the amount of such interest is reduced to a sum certain. Grand County Custom Homebuilding, LLC v. Bell, 148 P.3d 398 (Colo. App. 2006).

F. Accounts and Money Due on Account.

This section provides that interest shall be allowed upon all moneys after they become due. Peterson v. Shaffer, 143 Colo. 138, 352 P.2d 281 (1960).

Any creditor who can bring himself within the terms of this section is entitled to interest from his debtor. Stone v. Currigan, 138 Colo. 442, 334 P.2d 740 (1959); Massachusetts Bonding & Ins. Co. v. State ex rel. Mallin, 141 Colo. 259, 347 P.2d 507 (1959).

While this section does not say who shall pay interest, it necessarily follows that if a creditor is entitled to receive interest, his debtor must be charged with the payment thereof; if a judgment creditor is entitled to recover interest then the judgment debtor must be the one to pay it, since this section does not expressly or by implication exclude or except any judgment creditor or judgment debtor. Stone v. Currigan, 138 Colo. 442, 334 P.2d 740 (1959).

This section is clear and concise with reference to judgement creditors. Stone v. Currigan, 138 Colo. 442, 334 P.2d 740 (1959).

This section, because it imposes upon the debtor an additional burden in the way of damages for the withholding of money after it becomes due on account, should be strictly construed. Patten v. Am. Nat'l Bank, 15 Colo. App. 479, 63 P. 424 (1900); Smith-McCord-Townsend Co. v. Camenga, 104 Colo. 7, 87 P.2d 751 (1939); Hunter v. Wilson, 147 Colo. 36, 362 P.2d 553 (1961).

Meaning of word "account". The word "account", when used alone, as in this section, without words of limitation, extension, qualification, or explanation is sometimes equivalent to the word "claim" or "demand" when referring to an indebtedness arising out of contract or some fiduciary relation. Donley v. Bailey, 48 Colo. 373, 110 P. 65 (1910).

"Money due on account" includes fixed commission. As this section does not limit or

qualify the meaning of the word "account", the phrase "money due on account", must include the claim of one who by procuring a lease of lands for another earns a fixed sum as a commission, and he is entitled to interest from the time the claim became due, it being liquidated. Donley v. Bailey, 48 Colo. 373, 110 P. 65 (1910); Harvey v. Denver & R. G. R. R., 56 Colo. 570, 139 P. 1098 (1914).

The award of interest on commissions from the dates of the deeds, based on the reasonable determination that the commissions are due at such times, is proper. Manufacturer's Nat'l Bank v. Hartmeister, 411 F.2d 173 (10th Cir. 1969).

Interest may be recovered on a liquidated sum admitted to be due and payable on a day certain. Higgins v. Armstrong, 9 Colo. 38, 10 P. 232 (1886); Harvey v. Denver & R. G. R. R., 56 Colo. 570, 139 P. 1098 (1914).

This section in its present form has been carried over into the law of Colorado from early time, and the Colorado courts have traditionally required the allowance of interest on liquidated claims. N. Drive-In Theatre Corp. v. Park-In Theatres, Inc., 248 F.2d 232 (10th Cir. 1957).

The federal courts have given the statute a like construction. N. Drive-In Theatre Corp. v. Park-In Theatres, Inc., 248 F.2d 232 (10th Cir. 1957).

So where the amount payable under a contract is a liquidated amount, it falls within the definitions contained in the statute. York Plumbing & Heating Co. v. Groussman Inv. Co., 166 Colo. 382, 443 P.2d 986 (1968).

A liability fixed by law is a liquidated liability. T. & M. Transp. Co. v. Shattuck Chem. Co., 158 F.2d 909 (10th Cir. 1947).

For interest recovered by carrier under interstate commerce act, see T. & M. Transp. Co. v. Shattuck Chem. Co., 158 F.2d 909 (10th Cir. 1947).

State entitled to interest on taxes not paid to treasurer by state auditor. Where the state auditor keeps an account of the money received by him for taxes, which is due within 30 days after he receives it — that is, the statute requires him to pay it into the treasury within the 30 days — on each payment of taxes not paid over to the treasurer the state is entitled to interest under this section from the expiration of 30 days after its receipt by the auditor. Am. Bonding Co. v. People, 53 Colo. 512, 127 P. 941 (1912).

As towns and cities in business transactions are liable for interest, in the absence of statute, the same as private corporations or individuals, despite the conclusion reached by this court in Bd. of Comm'rs v. Wheeler, 39 Colo. 207, 89 P. 50 (1907), which was but dicta in that case. City of Golden v. W. Lumber & Pole Co., 60 Colo. 382, 154 P. 95 (1916).

In entering into a contract for services, a city lays aside its attributes of sovereignty and becomes liable just as an individual would be liable, including for interest. City & County of Denver v. Thomas, 176 Colo. 483, 491 P.2d 573 (1971).

A city which refuses or neglects payment of a just demand is liable for interest thereon. City of Golden v. W. Lumber & Pole Co., 60 Colo. 382, 154 P. 95 (1916).

Additionally, interest is allowable on mechanics' lien claims as an incident to the debt against the property. Buerger Inv. Co. v. Salzer Lumber Co., 77 Colo. 401, 237 P. 162 (1925).

Interest is allowed upon a balance due for work performed. Donley v. Bailey, 48 Colo. 373, 110 P. 65 (1910); Idaho Gold Coin Mining & Milling Co. v. Colo. Iron Works Co., 49 Colo. 66, 111 P. 553 (1910); Wells v. Crawford, 23 Colo. App. 103, 127 P. 914 (1912).

An unliquidated claim does not come within the statute as to allowance of interest. Hunter v. Wilson, 147 Colo. 36, 362 P.2d 553 (1961).

Where a claim for damages has never been settled, it is unliquidated, and therefore this section is not applicable. Credit Inv. & Loan Co. v. Guar. Bank & Trust Co., 166 Colo. 471, 444 P.2d 633 (1968).

Where the claim for damages for breach of warranty is unliquidated, such does not fall within the types of debts enumerated by the statute. York Plumbing & Heating Co. v. Groussman Inv. Co., 166 Colo. 382, 443 P.2d 986 (1968).

The mere fact that claims are in dispute does not preclude the recovery of interest thereon. N. Drive-In Theatre Corp. v. Park-In Theatres, Inc., 248 F.2d 232 (10th Cir. 1957).

The mere fact that one disputes the amount due on a bill does not render an account unliquidated; hence, one is therefore entitled to interest from the date he rendered his bill, at which time the account became due and payable. W. Oil Fields, Inc. v. Coit, 29 Colo. App. 567, 487 P.2d 562 (1971).

There is no requirement that the arbitration award be a monetary judgment before interest is awarded. Subsection (3) provides that interest shall be allowed even if the amount is unliquidated at the time of the wrongful withholding. Wilson v. Estate of Lawrence, 910 P.2d 67 (Colo. App. 1995).

A debtor cannot avoid the payment of interest by disputing the account, and when at the trial the account or any portion of it is established, the creditor is entitled to interest upon the amount found to be due. Florence & Cripple Creek R. R. v. Tennant, 32 Colo. 71, 75 P. 410 (1904); York Plumbing & Heating Co. v. Groussman Inv. Co., 166 Colo. 382, 443 P.2d 986 (1968).

Claiming unliquidated setoff against whole debt. A debtor cannot defeat the running of interest against him for the part of a debt which he admits that he owes, and which would otherwise draw interest, by simply making a claim of an unliquidated setoff against the whole debt. York Plumbing & Heating Co. v. Groussman Inv. Co., 166 Colo. 382, 443 P.2d 986 (1968).

Interest allowed only on balance due. Where a claim under an agreement is certain and liquidated, but is reduced because of the allowance of an unliquidated setoff or counterclaim, interest may be allowed only on the balance due. York Plumbing & Heating Co. v. Groussman Inv. Co., 166 Colo. 382, 443 P.2d 986 (1968).

Setoff should be at time due. The claim of the debtor not bearing interest should be set off against that of the creditor drawing interest as of the date of the time it became due and owing. York Plumbing & Heating Co. v. Groussman Inv. Co., 166 Colo. 382, 443 P.2d 986 (1968).

For the interest on "money due on settlement of an account from the day of the last just entry made on account" under earlier provision, see Bergundthal v. Bailey, 15 Colo. 257, 25 P. 86 (1890).

G. Money Fraudulently Converted.

Interest for tortious taking or detention of money or property. By distinguishing between interest as such and interest as damages the equivalent of interest in the way of damages for the tortious taking and detention of money or property is allowed, even when interest is not recoverable under the statute. Where interest is allowed as damages and there is an absence of proof as to the rate which would produce the amount the statutory legal rate should be adopted. Bankers Trust Co. v. Int'l Trust Co., 108 Colo. 15, 113 P.2d 656 (1941).

Where record does not disclose that amounts charged against a fiduciary were levied because of a fraudulent taking, there is no reversible abuse of discretion by the trial court in refusing interest on such amounts. Latta v. Henry, 28 Colo. App. 220, 472 P.2d 690 (1970).

III. NONALLOWANCE OF INTEREST.

There is no provision for interest upon damages resulting from the wrongful taking of property, and without statutory authority, it is not recoverable. Greeley, S. L. & Pac. Ry. v. Yount, 7 Colo. App. 189, 42 P. 1023 (1895); Banker's Trust Co. v. Int'l Trust Co., 108 Colo. 15, 113 P.2d 656 (1941).

Damages to property arising from the wrong or negligence of a defendant is not one of the enumerated cases. Denver, S. P. & P. R. R. v. Conway, 8 Colo. 1, 5 P. 142, 54 Am. R. 537 (1884).

An action in damage for a breach of warranty is not one of the enumerated cases. Weaver v. First Nat'l Bank, 138 Colo. 83, 330 P.2d 142 (1958).

Also, interest is not recoverable upon an unliquidated demand, for under all the authorities, even where interest is recoverable upon an unliquidated claim, it does not begin to run until the date of the demand, and the beginning of a suit is deemed equivalent to a demand. Denver, S. P. & P. R. R. v. Moynahan, 8 Colo. 56, 5 P. 811 (1884); Dexter v. Collins, 21 Colo. 455, 42 P. 664 (1895); T. & M. Transp. Co. v. Shattuck Chem. Co., 158 F.2d 909 (10th Cir. 1947); Schlottman v. Pressey, 195 F.2d 343 (10th Cir. 1952).

Interest cannot be allowed on unliquidated claims. Yeager Garden Acres, Inc. v. Summit Constr. Co., 32 Colo. App. 242, 513 P.2d 458 (1973); I.M.A., Inc. v. Rocky Mountain Airways, Inc., 713 P.2d 882 (Colo. 1986) (decided under former law).

In Colorado statutory interest cannot be awarded under this section on an unliquidated claim, but this does not end the matter. Statutory interest is one thing, but there is another kind of interest — moratory interest or interest by way of damages. Davis Cattle Co. v. Great W. Sugar Co., 393 F. Supp. 1165 (D. Colo. 1975), aff'd, 544 F.2d 436 (10th Cir. 1976), cert. denied, 429 U.S. 1094, 97 S. Ct. 1109, 51 L. Ed. 2d 541 (1977).

Interest is not allowable upon a balance due for work. Hurlburt v. Dusenbery, 26 Colo. 240, 57 P. 860 (1899).

Nothing contained in this section can be construed to authorize the recovery of interest in an action for damages for fraud and deceit. Clark v. Giacomini, 85 Colo. 530, 277 P. 306 (1929).

Interest is not recoverable on the amount of a verdict, although a substantial period of time (e.g., two years) has elapsed from the date of its rendition up to the time of the entry of judgment thereon. Hawley v. Barker, 5 Colo. 118 (1879).

County acting in governmental purpose not within this section. A county, being essentially an agency of the state for general governmental purposes, is not within the purview of this section regulating the rate and payment of interest upon money due or to become due from it. Roberts v. Bd. of County Comm'rs, 94 Colo. 149, 28 P.2d 813 (1934).

It was not the intention of the general assembly to allow interest upon claims against counties by virtue of this section, because § 5-12-104 provides that county orders and warrants and other like evidences or certificates of indebtedness shall bear interest at the rate of six percent. If it was intended that obligations of the county other than those mentioned in § 5-12-104 should draw interest, as provided in this

section, the enactment of this section would have been idle, because it provides for the allowance of interest "on any bond, bill, promissory note or other instrument of writing", which expressions are broad enough to include county orders and warrants and other like evidences of municipal indebtedness. The rule being that counties may not have liabilities imposed upon them in the absence of a statute, and the fact that the general assembly provided that county orders, warrants and other like evidences of municipal indebtedness shall bear interest, it must have intended to exclude all obligations other than those mentioned - expressio unius est exclusio alterius. Bd. of County Comm'rs v. Wheeler, 39 Colo. 207, 89 P. 50 (1907); City of Golden v. W. Lumber & Pole Co., 60 Colo. 382, 154 P. 95 (1916).

Interest is not recoverable against a municipal corporation on claims arising out of its actions in a governmental capacity. Police Pension & Relief Bd. v. Behnke, 143 Colo. 365, 353 P.2d 370 (1960).

Where the rights and duties of the parties are adjudicated and determined, then where plaintiffs have a money judgment, they are entitled to statutory interest thereon. Police Pension & Relief Bd. v. Behnke, 143 Colo. 365, 353 P.2d 370 (1960).

This section does not authorize the awarding of interest on overdue interest. It may be true that interest, when it has become payable, is "money become due", but a fair construction of this section will allow the language to cover only interest upon the principal, within the legislative intent, especially in view of the provision of § 5-12-103 allowing any rate to be agreed upon. So, this statute does not authorize the awarding of interest on overdue interest. Denver Brick, etc., Co. v. McAllister, 6 Colo. 261 (1882); Bd. of County Comm'rs v. Linn, 29 Colo. 446, 68 P. 839 (1902).

Where interest is claimed as damages and principal is accepted without interest right to interest is extinguished. Where interest is claimed as damages by virtue of the nonpayment of a debt when due, and for that reason is allowed by law, it is then considered not an integral part of a debt, but merely as an incident to the debt, and in such cases when the principal is paid and accepted without interest, the right to interest is extinguished. Bassick Gold Mine Co. v. Beardsley, 49 Colo. 275, 112 P. 770 (1911).

A protest for the nonpayment of the interest does not change this rule. Bassick Gold Mine Co. v. Beardsley, 49 Colo. 275, 112 P. 770 (1911).

Similarly, a receipt "in payment of above account" is a complete settlement, barring fraud or mistake, and precludes a subsequent claim of interest on the grounds that the amount was not paid promptly at its maturity. Bassick Gold Mine Co. v. Beardsley, 49 Colo. 275, 112 P. 770 (1911).

Section not applicable to judgment determining rights to funds paid into court. This statute, which allows judgment creditors to receive interest, does not apply to a judgment determining the right to funds paid into court, especially in an interpleader action, where the judgment is against the fund, not against the other parties. Ritter v. Wysowatcky, 32 Colo. App. 410, 514 P.2d 333 (1973).

Prejudgment interest cannot apply to punitive damage awards. Coale v. Dow Chem. Co., 701 P.2d 885 (Colo. App. 1985).

If there is a specific agreement for interest, but the right to interest has been waived, this section is not applicable. Ebrahimi v. E.F. Hutton & Co., Inc., 794 P.2d 1015 (Colo. App. 1989).

Where demand for payment under a performance bond was not made before suit was filed, interest on the judgment should be awarded to plaintiff only from the date the complaint was filed. Riva Ridge Apts. v. Robert G. Fisher Co., 745 P.2d 1034 (Colo. App. 1987).

Subsection (1) affords plaintiff no basis for recovery when the plaintiff's claim for interest arises from a personal injury and not as a creditor or a party to a contract. Subsection (1) generally pertains to post-judgment interest that applies to debt, contract, and property damage cases. Schnacker v. State Farm Mut. Auto. Ins. Co., 843 P.2d 102 (Colo. App. 1992).

Future wages and benefits are not "due" within meaning of this section. Therefore, prejudgment interest should not have been awarded on the portion of a judgment representing lost future wages and benefits. Shannon v. Colo. Sch. of Mines, 847 P.2d 210 (Colo. App. 1992); Dillen v. HealthOne, L.L.C., 108 P.3d 297 (Colo. App. 2004).

Prejudgment interest may not be awarded for future damages. Life Care Centers v. E. Hampden Assoc., 903 P.2d 1180 (Colo. App. 1995).

Prejudgment interest, under a theory of wrongful withholding, is not available on an award for attorney fees to compensate plaintiffs for the loss of use of their money. Roget v. Grand Pontiac, Inc., 5 P.3d 341 (Colo. App. 1999).

Consequential damages resulting from a wrongful withholding are not subject to prejudgment interest. Only the amounts actually withheld may draw interest under this section. S. Park Aggregates, Inc. v. Nw. Nat. Ins. Co., 847 P.2d 218 (Colo. App. 1992).

Section is inapplicable when another party absconded with the plaintiff's money. Defendant was not the party wrongfully withholding the money and did not realize a gain or benefit by retaining it. Messler v. Phillips, 867 P.2d 128 (Colo. App. 1993).

Prejudgment interest may not be awarded by trial court upon confirmation of arbitration award where such interest was not requested during the arbitration. Duncan v. Nat'l Home Ins. Co., 36 P.3d 191 (Colo. App. 2001).

Where an award of attorneys fees was properly characterized as analogous to costs rather than damages, the court abused its discretion by awarding moratory interest on the fees. Farmers Reservoir & Irrigation Co. v. City of Golden, 113 P.3d 119 (Colo. 2005).

An award of postjudgment interest is not proper when the award of wages to employee is used to set off the greater amount that employee owes employer for the special master's fee. Remote Switch Sys. v. Delangis, 126 P.3d 269 (Colo. App. 2005).

In the absence of any Colorado authority applying subsection (1) to an insurer's recoupment claim, and in light of the parties' plausible conflicting arguments about the statute's applicability, federal court of appeals was unable to conclude that insurers met their burden of establishing that Colorado law requires an award of prejudgment interest under the circumstances. Valley Forge Ins. Co. v. Health Care Mgmt. Partners, Ltd., 616 F.3d 1086 (10th Cir. 2010).

IV. NOTICE OR DEMAND.

Some kind of notice must be given debtor before creditor can recover interest. The only reasonable construction of this section is that even though a debtor may be unable to pay, and a demand therefor be excusable to that extent, still there must be some notice to him of some kind, either by the institution of a suit, or otherwise, of the creditor's intention to terminate the relation of debtor and creditor by declaring the maturity of a debt, or some act of the creditor evidencing such desire and intention, before he can be allowed to recover interest. Patten v. Am. Nat'l Bank, 15 Colo. App. 479, 63 P. 424 (1900).

The relation between a bank and its depositor is that of debtor and creditor, the debt becoming due and payable on demand, and even though a bank may be unable to pay, and a demand therefore be excusable to that extent, still there must be some notice by the depositor of his intention of terminating the relation of debtor and creditor by declaring the maturity of the debt before he can recover interest on his deposit under this section. Patten v. Am. Nat'l Bank, 15 Colo. App. 479, 63 P. 424 (1900).

Hence, no interest on bank account until demand is made. In cases of general deposits in a bank, unless there be some agreement or usage to the contrary, the undertaking of the bank is only to repay upon demand. Such an account, therefore, does not become due under this section until demand is made for it, and the bank is not in default, or liable to respond in damages, until such demand and refusal. Hence, under this general rule, a plaintiff is not entitled to receive interest on his deposit, unless the circumstances were such as to legally excuse him from making a demand prior to the time when he did make it. Patten v. Am. Nat'l Bank, 15 Colo. App. 479, 63 P. 424 (1900).

The fact that a bank is temporarily suspended and its assets are temporarily in the hands of a receiver appointed by the government does not excuse a depositor from making demand so as to render the account due and cause it to draw interest without demand. Patten v. Am. Nat'l Bank, 15 Colo. App. 479, 63 P. 424 (1900).

Interest, whether as damages or under this section, must be given from the date of the demand of payment for labor performed and materials furnished. In an action at law on a contract for work done and materials furnished, this section, respecting the allowance of interest, is mandatory. It leaves no discretion in the court to take into consideration, as in equity cases, the laches of the demandant in bringing the suit. City of Denver v. Barber Asphalt Paving Co., 141 F. 69 (8th Cir. 1905).

Absent any agreement by the parties on interest, interest becomes due after payment at the statutory rate on the unpaid balance of the principal from the date that demand for payment is made. Knisley v. Parsons, 172 Colo. 533, 474 P.2d 599 (1970).

Where money is to be paid if third party does not, it is unnecessary to make a demand. Where a contract provides that the parties of the first part will pay the party of the second part a certain sum of money if the sum is not paid by a third party within a specified time, and such third party fails to do so, then it is not necessary to either make a demand upon such third party for payment or to notify the parties of the first part of such failure in order to mature the obligation so as to draw interest in accordance with this section, as the money becomes due upon the failure to pay at the expiration of the specified time and the allowance of interest from the date of the commencement of the suit does not constitute prejudicial error. Doyle v. Nesting, 37 Colo. 522, 88 P. 862 (1907), distinguishing Dexter v. Collins, 21 Colo. 455, 42 P. 664 (1895).

In the context of determining when payment of debt is wrongfully withheld, either formal demand or circumstances demonstrating a reasonable expectation of payment renders nonpayment wrongful. A letter from an accounting firm satisfied the need for a formal demand for payment, under the theory of wrongful withholding. The parties had retained the firm to examine their mutual accounts and determine their respective obligations. The firm determined the amount of each party's debt and

communicated the amounts in a letter to each party. The letter established a present expectation of payment of which both parties were aware. Thus the letter satisfied the need for a formal demand for payment. Karg v. Mitchek, 983 P.2d 21 (Colo. App. 1998).

V. COMPUTATION.

Interest should start to run from the date of the entry of a judgment. Weaver v. First Nat'l Bank, 138 Colo. 83, 330 P.2d 142 (1958).

At six percent. Under this section, upon execution or satisfaction of judgments, interest should be collected at six percent per annum from the date of each judgment. Davies v. Craig, 70 Colo. 473, 203 P. 267 (1921).

Interest should begin accruing on the date the defendant began wrongfully withholding the joint venture funds. The defendant had a reasonable time in which to wind up the joint venture. The trial court found that he willfully failed to do so, and accordingly, pursuant to the statute, interest should have been awarded from date the willful delay began. Wilson v. Estate of Lawrence, 910 P.2d 67 (Colo. App. 1995).

One who is damaged by a breach of duty may recover prejudgment interest from the date of the breach, since it is the breach itself that makes the conduct wrongful. Porter Constr. Servs. v. Ehrhardt, Keefe, Steiner, and Hottman, P.C., 131 P.3d 1115 (Colo. App. 2005).

Thus, a judgment against a local government bears interest from the date of its entry. Stone v. Currigan, 138 Colo. 442, 334 P.2d 740 (1959).

Interest allowed from date of filing complaint. This section concerning interest on damage claims is mandatory to the end that a trial judge shall compute and enter interest on any verdict or judgment calculated from the date of the filing of the complaint. Green v. Jones, 134 Colo. 208, 304 P.2d 901 (1956); Denver-Albuquerque Motor Transp., Inc. v. Galligan, 145 Colo. 71, 358 P.2d 28 (1960).

A trustee in bankruptcy who sues for the value of stock issued by an insolvent corporation is entitled to interest from the date of commencing his action. Feiring v. Gano, 114 Colo. 567, 168 P.2d 901 (1946).

Interest computed from date of performance on plaintiff's part. Where there was a balance due plaintiffs under a written contract which had on plaintiff's part been fully performed prior to a certain date, this date is the date from which interest should be computed, if allowed, and the amount being due on a written instrument, plaintiffs are entitled to interest under this section, unless there had been a tender made by defendant. And a deposit of the amount due in court "payable to the plaintiff on demand" is not a tender. Harvey v. Denver & R. G. R. R., 56 Colo. 570, 139 P. 1098 (1914).

Money not turned over by treasurer to successor draws interest from date latter assumed office. Money in the hands of a county treasurer belonging to a county and not turned over to his successor at the time the latter assumed the duties of the office would draw interest under this section at the legal rate from that date, and the sureties on his official bond are liable to the county for such money with interest. Gartley v. People ex rel. Pueblo County, 28 Colo. 227, 64 P. 208 (1901).

Agent who converts principal's money is liable for interest from date of transaction. An agent, who being employed to lend the money of his principal converts it to his own use is liable either in assumpsit or in an action ex delicto for the interest upon the money under this section, from the date of the transaction. Boyle v. Poor, 62 Colo. 337, 163 P. 967 (1916).

Interest allowed on account when due. Where in an action containing three counts, the first upon a stated account, the second upon an open book account, and the third for money had and received, plaintiff is entitled to interest on the first count from the date the account was stated, and on the second count from the date the account became due and payable, but disallowed interest on the third. Mine & Smelter Supply Co. v. Parke & Lacy Co., 107 F. 881 (8th Cir. 1901).

Under this section, a party furnishing supplies to a corporation pursuant to a written contract providing that the amount furnished in each calendar month shall be paid for on a day certain in the succeeding month is to be allowed interest on each monthly amount from the day it matures until payment made. Florence Oil & Ref. Co. v. McRae, 40 Colo. 303, 90 P. 507 (1907); Bassick Gold Mine Co. v. Beardsley, 49 Colo. 275, 112 P. 770 (1911).

Similarly, interest from due date of rent is allowed. In an action for money due for rent by virtue of a written lease, the claim sued on is clearly included in this section, and the plaintiff is entitled to interest from the due date of the installments of rent to the date of judgment. Wells v. Crawford, 23 Colo. App. 103, 127 P. 914 (1912); Lamar Cold Storage Co. v. Union Ice & Storage Co., 77 Colo. 556, 238 P. 42 (1925); Macaluso v. Easely, 81 Colo. 50, 253 P. 397 (1927).

The fact that the court does not at the time of the entry of judgment compute the amount of the interest accrued to that date is not material; the computation can be made at any time. Massachusetts Bonding & Ins. Co. v. State ex rel. Mallin, 141 Colo. 259, 347 P.2d 507 (1959).

When no authority for interest from date of executor's sale. Where an executor contends that the trial court erred in awarding interest on the amount received from the property from the date of sale, rather than only from the date of judgment, then, where there has been no show-

ing and no finding on the part of the trial court that the money received was held without the owner's consent, there is no authority for the award of interest from the date of sale. In re Estate of Granberry, 30 Colo. App. 590, 498 P.2d 960 (1972).

Where a partnership is dissolved by one partner selling to his co-partners his interest at a fixed cash sum, an unpaid balance of the purchase price under this section will draw interest at the legal rate from the date of the transaction. Cobb v. Benedict, 27 Colo. 342, 62 P. 222 (1900).

In an action for an accounting where a joint venturer seeks to recover his share of the profits, he is entitled to the legal rate of interest from the date of demand to the date of filing of the master's report. Pepper v. Hyman, 117 Colo. 365, 189 P.2d 155 (1947).

The offset of an unliquidated claim against a liquidated claim before the computation of interest is permitted, at least in situations in which the two claims arise out of the same general transaction. York Plumbing & Heating Co. v. Groussman Inv. Co., 166 Colo. 382, 443 P.2d 986 (1968).

Where the claims do not arise out of the same general transaction, the offset of an unliquidated claim against a liquidated claim before computation of interest is not permitted. Karg v. Mitchek, 983 P.2d 21 (Colo. App. 1998).

Under the terms of an agreement with a bank, the amount which an armored motor service was obligated to pay the bank as a result of a robbery from their truck became due the day the bank's money disappeared from the truck. Accordingly, the bank was entitled to interest on that obligation, arising under the instrument of writing, from and after that date. Jefferson County Bank v. Armored Motors Serv., 148 Colo. 343, 366 P.2d 134 (1961).

Where a note is made payable "with interest", without specifying the rate, or the time from which the interest is to be computed, the general rule is that the note carries interest from the date of its execution at the legal rate fixed by law. Salazar v. Taylor, 18 Colo. 538, 33 P. 369 (1893).

Where the stated rate on a note is unintelligible, this rule likewise applies, and the legal rate fixed by this section would govern. Salazar v. Taylor, 18 Colo. 538, 33 P. 369 (1893).

Compound interest may not be recovered. Denver Brick & Mfg. Co. v. McAllister, 6 Colo. 261 (1882).

This rule does not apply to unpaid coupons of municipal bonds. The rule that compound interest may not be recovered does not apply to unpaid coupons belonging to or cut from municipal bonds; interest may be recovered on overdue coupons on county bonds. Bd. of Comm'rs v. Linn, 29 Colo. 446, 68 P. 839 (1902).

Such coupons draw interest after maturity. City of Cripple Creek v. Adams, 36 Colo. 320, 85 P. 184 (1906).

Mode of determining property value for services and consumption. Where the property is domestic animals, valuable for service only, the value of the use of the animal is the measure of compensation, and where the article is intended for consumption, interest upon the value of it would seem to be the true compensation. Thus, if the owner of goods should ask to obtain the like quantity, he must purchase in the market at current rates, and he would be deprived of the use of the money thus invested, the best estimate of a loss that can be made is interest upon the amount of money which he would for that purpose be compelled to pay out. Arkansas Valley Land & Cattle Co. v. Mann, 130 U.S. 69, 9 S. Ct. 458, 32 L. Ed. 854 (1899).

Interest upon the cost of a silver mill might be taken by a jury as its fair rental value, in the absence of other evidence concerning that value. New York & Colo. Mining Syndicate & Co. v. Fraser, 130 U.S. 611, 9 S. Ct. 665, 23 L. Ed. 1031 (1889).

Interest on damages for injuries to property or torts commences on date of judgment. The Colorado statute dealing with interest on damages provides that in personal injury cases interest commences as of the date of the filing of the complaint. No mention is made of property injuries or torts. Inasmuch as these are unliquidated, the general rule is that the interest commences to run as of the date of judgment. Westric Battery Co. v. Standard Elec. Co., 482 F.2d 1307 (10th Cir. 1973).

Interest allowed from date defective product was installed, since product was defective at the time of installation. Loughridge v. Goodyear Tire & Rubber Co., 281 F. Supp. 2d 1252 (D. Colo. 2003), aff'd, 431 F.3d 1268 (10th Cir. 2005).

Interest awarded on breach of contract judgment from time money due. The court concluded there was a binding contract between the parties; thus the judgment was based upon breach of contract rather than quantum meruit and interest was properly awarded from the time the money was due. Warde v. Davis, 494 F.2d 655 (10th Cir. 1974); Danburg v. Realties, Inc., 677 P.2d 439 (Colo. App. 1984).

Interest from date of filing of counterclaim. Subsections (1)(b) and (3) provide that interest shall be from the time moneys were wrongfully withheld or became due and where there is no evidence of any wrongful withholding or demand or expectation of payment by claimant prior to the filing of the counterclaim, trial court was correct in awarding prejudgment interest from such date. W.H. Woolley & Co. v. Bear Creek Manors, 735 P.2d 910 (Colo. App. 1986).

Plaintiff is entitled to interest from the time his action accrues. Action for rescission arose

when plaintiff amended his complaint and first requested rescission. Prior to that demand, there was no wrongful withholding of the money paid for the house. Wall v. Foster Petroleum Corp., 791 P.2d 1148 (Colo. App. 1989).

No exception for mandamus action. Under this section, the trial court is required to assess interest at the rate of eight percent on any judgment rendered to run from the date of the judgment, and no exception is made for a mandamus action. Denver Ass'n for Retarded Children v. Sch. Dist. No. 1, 188 Colo. 310, 535 P.2d 200 (1975).

Where judgment in favor of plaintiff was affirmed on appeal but case was remanded for a new trial on the issue of damages, and trial court on remand determined damages and entered judgment thereupon, plaintiff was entitled to interest on that amount only from the date the later judgment was entered. Yeager Garden Acres, Inc. v. Summit Const. Co., 32 Colo. App. 242, 513 P.2d 458 (1973).

Prejudgment interest awarded from date of judgment quieting title to disputed property. Prejudgment interest on royalties from oil and gas extraction from disputed property awarded only from the date plaintiff won judgment quieting title in the property and not from earlier date on which plaintiff asserted an ownership claim to the property. Royalty payments could not be considered to be wrongfully withheld until plaintiff's ownership of the property was no longer in dispute. Beaver Creek Ranch v. Gordman Leverich Ltd., 226 P.3d 1155 (Colo. App. 2009).

Insurer paid interest from date judgment entered to date liability was paid. An insurer was obligated to pay all interest accruing on a judgment from the date of its entry to the date on which it paid the amount of its liability under the policy. Houser v. Eckhardt, 35 Colo. App. 155, 532 P.2d 54 (1974), aff'd, 191 Colo. 189, 552 P.2d 308 (1976).

To award a buyer the additional cost of cover as well as the entire benefit realized by the seller would be duplicative in the calculation of moratory interest in the case of a seller's wrongful withholding of property by breaching a sales contract. Great W. Sugar Co. v. KN Energy, Inc., 778 P.2d 272 (Colo. App. 1989).

Section requires that prejudgment interest be awarded where money is wrongfully withheld. Because rescission is an equitable remedy, the court has discretion is determining the appropriate relief for the parties and such an award of prejudgment interest must be incorporated in the court's assessment of the equities. Wall v. Foster Petroleum Corp., 791 P.2d 1148 (Colo. App. 1989).

Fact that amount due is disputed or unclear does not render a claim unliquidated for purposes of awarding interest under subsection (4). Montgomery Ward & Co. v. State, Dept. of Rev., 675 P.2d 318 (Colo. App. 1983).

Interest awarded on judgment against natural gas pipeline company for refusal to honor contract to sell natural gas to buyer at a reduced, industrial rate may properly be calculated using "gas husbanding model", the equation being seller's return on rate base, plus seller's excess profits, minus seller's operating profit credit. Great W. Sugar Co. v. KN Energy, Inc., 778 P.2d 272 (Colo. App. 1989).

To the extent that an award made under the statute provides double compensation for the same wrong, it cannot stand. The wording and legislative history of subsection (1)(a) and the commitment to fairness underlying the doctrine of moratory interest leads to the conclusion that the statute may not be used to impose double or other punitive damages. Great W. Sugar Co. v. KN Energy, Inc., 778 P.2d 272 (Colo. App. 1989).

Interest from the time the action accrues is proper in a case where demand for payment is not an element of the plaintiff's case. Deacon v. Am. Plant Food Corp., 782 P.2d 861 (Colo. App. 1989), rev'd on other grounds sub nom. Stone's Farm Supply, Inc. v. Deacon, 805 P.2d 1109 (Colo. 1991).

Wife is entitled to statutory interest from date of closing on her share of proceeds from home sale ordered as part of property division in a marital dissolution action. Such interest is proper to enforce the judgment. In re Schutte, 721 P.2d 160 (Colo. App. 1986); In re Connell, 831 P.2d 913 (Colo. App. 1992).

Without proof of defendant's gain, the statutory rate of interest applies. Ballow v. PHICO Ins. Co., 878 P.2d 672 (Colo. 1994).

Standard applied in Atlantic Richfield Co. v. Farm Credit Bank of Wichita, 226 F.3d 1138 (10th Cir. 2000).

When jury's award does not distinguish between past and future wages, it still may be possible to apportion award based on a number of available formulas. Shannon v. Colo. Sch. of Mines, 847 P.2d 210 (Colo. App. 1992).

Date when a claim accrues for statute of limitations purposes is independent from the date of the wrongful withholding for the purpose of awarding interest. Eads v. Dearing, 874 P.2d 474 (Colo. App. 1993; Loughridge v. Goodyear Tire & Rubber Co., 281 F. Supp. 2d 1252 (D. Colo. 2003), aff'd, 431 F.3d 1268 (10th Cir. 2005).

Where trial court found that wrongful withholding occurred in 1980, even though plaintiff did not discover the wrongful withholding until 1989, court correctly awarded interest from 1980. Eads v. Dearing, 874 P.2d 474 (Colo. App. 1993).

District court erred in awarding prejudgment interest from the time of the initial breach of express warranty since there were

consequential damages that had not yet been incurred. Court should calculate prejudgment interest on each portion of the damages from the time each element of consequential damages was incurred. Pegasus Helicopters, Inc. v. United Technologies Corp., 35 F.3d 507 (10th Cir. 1994).

Prejudgment interest awarded from date of breach of fiduciary duty, not date royalties would have been received. Vento v. Colo. Nat'l Bank-Pueblo, 907 P.2d 642 (Colo. App. 1995).

Prejudgement interest awarded from date embezzlement occurred, not the date employees discovered the financial problems caused by the embezzlement or date of discovery of negligence. Porter Constr. Servs. v. Ehrhardt, Keefe, Steiner, and Hottman, P.C., 131 P.3d 1115 (Colo. App. 2005).

Prejudgment interest awarded from the date the money is wrongfully withheld or becomes due. In determining when payment is wrongfully withheld, formal demand or circumstances demonstrating a reasonable expectation of payment render the nonpayment wrongful. Paratransit Risk Retention Group Ins. Co. v. Kamins, 160 P.3d 307 (Colo. App. 2007).

Under subsection (1)(b), wrongful withholding of replacement cost damages occurs when plaintiff actually undertakes replacement expenditures. Prejudgment interest therefore begins to accrue on that date and not on the earlier date when the wrong subsequently remedied by the replacement expenditures actually occurred. Goodyear Tire & Rubber Co. v. Holmes, 193 P.3d 821 (Colo. 2008); Ferrellgas, Inc. v. Yeiser, 247 P.3d 1022 (Colo. 2011).

Interest payable for fraudulently obtained food stamps accrues from the time the state reimburses the federal government for the fraudulently obtained food stamps. Interest should accrue only from the time of the actual injury and the state suffers actual loss only when it reimburses the federal government. Valenzuela v. People, 893 P.2d 97 (Colo. 1995).

In breach of contract cases, action accrues when breach and damages occur, and prejudgment interest accrues from the time of the breach, not from the entry of judgment. Bd. of County Comm'rs of Adams County v. City & County of Denver, 40 P.3d 25 (Colo. App. 2001).

5-12-103. Greater rate may be stipulated. (1) The parties to any bond, bill, promissory note, or other instrument of writing may stipulate therein for the payment of a greater or higher rate of interest than eight percent per annum, but not exceeding forty-five percent per annum, and any such stipulation may be enforced in any court of competent jurisdiction in the state, except as otherwise provided in articles 1 to 6 of this title. The rate of interest shall be deemed to be excessive of the limit under this section only if it could have been determined at the time of the stipulation by mathematical computation that such rate would exceed an annual rate of forty-five percent when the rate of interest was calculated on the unpaid balances of the debt on the assumption that the debt is to be paid according to its terms and will not be paid before the end of the agreed term.

(2) The term "interest" as used in this section means the sum of all charges payable directly or indirectly by a debtor and imposed directly or indirectly by a lender as an incident to or as a condition of the extension of credit to the debtor, whether paid or payable by the debtor, the lender, or any other person on behalf of the debtor to the lender or to a third party.

(3) The public policy of this state does not limit or prohibit contracting, agreeing, or stipulating in advance for the payment of interest on interest or compound interest.

(4) No law or public policy of this state limiting interest on interest, the adding of deferred interest to principal, or the compounding of interest shall apply to any promissory note secured by any mortgage or deed of trust or to one secured by a mortgage or deed of trust where periodic disbursement of part of the loan proceeds is made by a lender over a period of time as established by the mortgage or deed of trust, or over an expressed period of time, or ending with the death of the debtor, including, but not limited to, promissory notes secured by mortgages or deeds of trust having provisions for adding deferred interest to principal or otherwise providing for the charging of interest on interest.

(5) This section shall not apply to a commercial credit plan as defined in section 5-12-107 (8) and extensions of credit made pursuant thereto, unless the bond, bill, promissory note, instrument, or other written agreement evidencing the plan expressly states that it is subject to this section.

Source: L. 71: R&RE, p. 852, § 1. **C.R.S. 1963:** § 73-12-103. **L. 72:** p. 292, § 6. **L. 75:** (1) amended, p. 257, § 3, effective July 1. **L. 79:** (2) amended and (3) and (4)

added, p. 317, § 1, effective July 1. **L. 81:** (4) amended, p. 396, § 33, effective June 8. **L. 96:** (5) added, p. 407, § 12, effective July 1.

COLORADO COMMENT

This section was amended to correspond to the usury limitations of Section 18-15-104 of the Colorado Criminal Code. This section now provides for a ceiling on interest of forty-five percent. (This same ceiling was added to Section 5-3-605.)

ANNOTATION

Law reviews. For note, "Colorado Interest Law", see 34 Dicta 398 (1957). For article, "The Revolution in Consumer Credit Legislation", see 45 Den. L.J. 679 (1968). For article, "Colorado Usury", see 11 Colo. Law. 2557 (1982). For article, "Collecting Pre- and Post-Judgment Interest in Colorado: A Primer", see 15 Colo. Law. 753 (1986). For article, "An Update of Appendices from Collecting Pre- and Post-Judgment Interest in Colorado", see 15 Colo. Law. 990 (1986). For article, "Colorado Usury: The Sequel - Parts I and II", see 23 Colo. Law. 565 and 829 (1994).

Annotator's note. Since § 5-12-103 is similar to repealed § 73-1-3, C.R.S. 1963, § 73-1-3, CRS 53, CSA, C. 88, § 3, and laws antecedent to CSA, C. 88, § 3, relevant cases construing those provisions have been included in the annotations to this section.

There is no question regarding the authority of the general assembly to make the provision in this section that a rate of interest is a matter of contract which parties may evidence in writing. Wigton v. Elliott, 49 Colo. 115, 111 P. 713 (1910).

This section does not operate to preclude the general assembly from subsequently restricting interest rates by legislation. Waddell v. Traylor, 99 Colo. 576, 64 P.2d 1273 (1937).

Parties are at liberty under this section to stipulate for such rate of interest as they may see fit. McKay's Estate v. Belknap Sav. Bank, 27 Colo. 50, 59 P. 745 (1899).

National banks in Colorado have equal rights with others to collect interest upon loans at any agreed rate. Rockwell v. Farmers' Nat'l Bank, 4 Colo. App. 562, 36 P. 905 (1894).

National banks may make the rate dependent upon the happening of a contingency, if they so elect. McKay's Estate v. Belknap Sav. Bank, 27 Colo. 50, 59 P. 745 (1899).

Contingent amounts of interest cannot be considered when determining whether a contractual rate of interest is usurious. Beeler v. H & R Block of Colo., Inc., 487 P.2d 569 (1971); Uniwest Mortgage Co. v. Dadecor Condominiums, Inc., 877 F.2d 431 (5th Cir. 1989).

Nonpayment of principal or interest when due. It is competent for the parties to agree upon an increased rate contingent upon nonpayment of either principal or interest when due. McKay's Estate v. Belknap Sav. Bank, 27 Colo. 50, 59 P. 745 (1899); In Re Wood Family Interests, Ltd., 135 Bankr. 407 (Bankr. D. Colo. 1989).

Usurious interest rate enforceable at maximum allowable rate. If a note has a higher interest rate than is allowed by this section, it will be invalid to the extent that the interest rate is usurious, but it will still be enforced at the maximum allowable rate. Becker v. Marketing & Research Consultants, Inc., 526 F. Supp. 166 (D. Colo. 1981); Brown v. Fenner, 757 P.2d 184 (Colo. App. 1988); Concord Realty v. Cont'l Funding, 776 P.2d 1114 (Colo. 1989).

Parties to contract are free to set rate of interest by mutual agreement. Martinez v. Cont'l Entrs., 730 P.2d 308 (Colo. 1986).

The parties to a note unquestionably have the right to stipulate that a larger rate should be paid upon the failure to pay a smaller one when due; such stipulation may be enforced in any court of competent jurisdiction. McKay's Estate v. Belknap Sav. Bank, 27 Colo. 50, 59 P. 745 (1899); In Re Wood Family Interests, Ltd., 135 Bankr. 407 (Bankr. D. Colo. 1989).

Stipulation in a promissory note of an increased rate of interest after maturity is not a penalty. Godsmark v. Bennett's Estate, 52 Colo. 198, 120 P. 151 (1912).

Rather, a stipulation for interest after maturity of a note is regarded as damages for breach of contract. Browne v. Steck, 2 Colo. 70 (1873).

The parties may stipulate that a larger rate be paid so long as the rate bears a reasonable relation to the current rate of interest. Browne v. Steck, 2 Colo. 70 (1873).

The rate of interest agreed upon in writing must be allowed according to the terms of an agreement until the entry of judgment. McKay's Estate v. Belknap Sav. Bank, 27 Colo. 50, 59 P. 745 (1899).

When, at the place of contract, the rate of interest differs from that of the place of payment, the parties may stipulate for either rate, and the contract will govern, the parties having the right of election as to the law of which place their contract is to be governed. McKay's Estate v. Belknap Sav. Bank, 27 Colo. 50, 59 P. 745 (1899).

Where no evidence is introduced of the current rate of interest, the party's stipulation may be accepted. Browne v. Steck, 2 Colo. 70 (1873).

If rate specified greatly exceeds the real value of money it will be disallowed as a penalty. Under this section the parties may determine the value of the use of money before it falls due, and their estimate of its value, after it falls due, is the true measure of damages, until it is shown to be incorrect. Since the law seeks to indemnify the plaintiff for the loss he has suffered by the breach of contract, the rate fixed by the parties affords a just rule of indemnity. If, however, the rate of interest specified in the contract greatly exceeds the real value of the money, it is a penalty for the nonpayment of the principal sum, rather than a just recompense for detaining it, and will not be allowed. Browne v. Steck, 2 Colo. 70 (1873).

Such a provision is waived by the acceptance of interest at the original rate after maturity. Godsmark v. Bennett's Estate, 52 Colo. 198, 120 P. 151 (1912).

Furthermore, when interest becomes due it represents an indebtedness which the interested parties may then make the subject of a new contract by stipulating in writing when and how it shall be paid and what rate of interest it shall bear until paid, inasmuch as after interest becomes due, it may, by agreement, be turned into principal and bear interest. Hochmark v. Richler, 16 Colo. 263, 26 P. 818 (1891); Wigton v. Elliott, 49 Colo. 115, 111 P. 713 (1910), distinguishing Denver Brick & Mfg. Co. v. McAllister, 6 Colo. 261 (1882).

Such an arrangement is not compounding interest. Wigton v. Elliott, 49 Colo. 115, 111 P.713 (1910).

Compound interest contracted for in advance is, in general, not recoverable. Hochmark v. Richler, 16 Colo. 263, 26 P. 818 (1891).

Such a contract is per se unlawful. Hochmark v. Richler, 16 Colo. 263, 26 P. 818 (1891).

The fact that compound interest is provided for does not, however, render the entire contract usurious and void; rather upon grounds of public policy, simply decline to enforce payment of the interest upon interest. Hochmark v. Richler, 16 Colo. 263, 26 P. 818 (1891).

A promise for such made after interest has accrued is legal. A promise to pay compound interest made after instead of before the interest to be compounded has accrued is legal and enforceable. Hochmark v. Richler, 16 Colo. 263, 26 P. 818 (1891).

Though compound interest is allowable only when there is a definite agreement for such. Tarabino Real Estate Co. v. Tarabino, 109 Colo. 425, 126 P.2d 859 (1942).

Moreover, "instrument of writing" must express mutuality of contract. This section clearly implies that the "instrument of writing" referred to must be one expressing mutuality of contract. Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1914).

A will is not within section. A will does not rest on contract relations, and is therefore not an instrument into which a stipulation between the parties for interest, as contemplated by this section, could be injected. Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1914).

Hence, no interest is allowed on legacies. Since there is nothing in this section, either express or implied, providing for interest on legacies, none is allowable. Cobb v. Stratton's Estate, 56 Colo. 278, 138 P. 35 (1914).

Late charges provided for in connection with a nonconsumer credit arrangement were reasonable as a matter of law and enforceable where charges constituted a "default interest" charge for debtor's failure to pay off the note according to its terms and the rate per annum was less than 45%. Dikeou v. Dikeou, 928 P.2d 1286 (Colo. 1996).

5-12-104. Warrants to bear six percent. County orders and warrants, town and city and school orders and warrants, and other like evidences or certificates of municipal indebtedness, shall bear interest at the rate of six percent per annum from the date of the presentation thereof for payment at the treasury where the same may be payable, until there is money in the treasury for the payment thereof, except when otherwise specially provided by law. Every county treasurer, town treasurer, and city treasurer to whom any such county, town, city, or school order or warrant is presented for payment, and who shall not have on hand the funds to pay the same, shall endorse thereon the rate of interest said order or warrant will draw, and the date of such presentation, and subscribe such endorsement with his official signature; however, all such orders and warrants may be made to bear a lower rate of interest than above specified, by special agreement between such counties, towns, and cities issuing the same, and the person to whom such orders or warrants are issued.

Source: L. 71: R&RE, p. 852, § 1. **C.R.S. 1963:** § 73-12-104.

ANNOTATION

Annotator's note. Since § 5-12-104 is similar to repealed laws antecedent to CSA, C. 88, § 4, relevant cases construing those provisions have been included in the annotations to this section.

The evident intent of this section is first, to place a uniform rate of interest upon a specific class of obligations, and second, to make it impossible for county, town, city, or school district officials to agree, as otherwise under § 5-12-103 they might do, to pay a higher rate of interest upon such securities than that fixed by statute. That it was the intention of the general assembly to preclude the recovery of interest, except by express agreement, on all other county, city, town, or school district indebtedness is clear. City of Golden v. W. Lumber & Pole Co., 60 Colo. 382, 154 P. 95 (1916).

This section in no manner limits, qualifies, or changes the effect and purpose of § 5-12-102, except as to a particular class of securities; by that section creditors are entitled to interest on claims therein mentioned at the rate of six percent per annum from all debtors. The conclusion reached in Bd. of Comm'rs v. Wheeler, 39 Colo. 207, 89 P. 50 (1907), which appears to be contra, therefore, has no bearing upon the question of the liability of towns and cities for interest. Any other holding would have the effect to exempt cities and towns from the payment of interest on judgments against them. Section 5-12-104 plainly applies to cities and towns, and gives a creditor the right to recover interest upon claims growing out of business transactions with them, whenever, under like circumstances, he might lawfully do so from a private corporation or individual. City of Golden v. W. Lumber & Pole Co., 60 Colo. 382, 154 P. 95 (1916).

Thus, towns and cities in business transactions are liable for interest the same as private corporations or individuals. City of Golden v. Western Lumber & Pole Co., 60 Colo. 382, 154 P. 95 (1916), distinguishing Bd. of Comm'rs v. Wheeler, 39 Colo. 207, 89 P. 50 (1907) (applied to a county as an involuntary organization).

So counties are liable for interest on interest coupons the same as individuals. Since the evident purpose of this section is to place counties practically upon the same plane as individuals with respect to the payment of interest upon their written evidences of indebtedness, with a limitation as to rate, counties are liable for interest on interest coupons the same as individuals. Bd. of Comm'rs v. Linn, 29 Colo. 446, 68 P. 839 (1902).

Municipal corporation not liable for interest for services rendered. Under this section municipal corporations cannot in any manner be made liable for or legally pay interest upon an account for services rendered. City of Colo. Springs v. Coray, 25 Colo. App. 460, 139 P. 1031 (1913).

5-12-105. Interest upon foreclosure. In all cases where real estate shall be sold under execution or by virtue of the foreclosure of any mortgage, deed of trust, or other lien, the indebtedness and costs for which any certificate of purchase may issue shall bear interest at the rate specified in the original instrument.

Source: L. 71: R&RE, p. 852, § 1. **C.R.S. 1963:** § 73-12-105.

ANNOTATION

Law reviews. For article, "Forms Committee Presents Additional Standard Pleading Samples for Use in Foreclosures Through Public Trustee", see 29 Dicta 1 (1952).

5-12-106. Rate of interest on judgments which are appealed. (1) Except as provided in section 13-21-101, C.R.S., where there is no written agreement as to the rate of interest, creditors shall receive interest as follows:

(a) If a judgment for money in a civil case is appealed by a judgment debtor and the judgment is affirmed, interest, as set out in subsections (2) and (3) of this section, shall be payable from the date of entry of judgment in the trial court until satisfaction of the judgment and shall include compounding of interest annually.

(b) If a judgment for money in a civil case is appealed by a judgment debtor and the judgment is modified or reversed with a direction that a judgment for money be entered in the trial court, interest, as set out in subsections (2) and (3) of this section, shall be payable from the date a judgment was first entered in the trial court until the judgment is satisfied and shall include compounding of interest annually. This interest shall be payable on the amount of the final judgment.

(2) (a) The rate of interest shall be certified on each January 1 by the secretary of state to be two percentage points above the discount rate, which discount rate shall be the rate of interest a commercial bank pays to the federal reserve bank of Kansas City using a government bond or other eligible paper as security, and shall be rounded to the nearest full percent. Such annual rate of interest shall be so established as of December 31, 1982, to become effective January 1, 1983. Thereafter, as of December 31 of each year, the annual rate of interest shall be established in the same manner, to become effective on January 1 of the following year.

(b) Notwithstanding any other provision of this subsection (2), the rate of interest shall be no lower than the percentage authorized in section 5-12-102 (4) (b).

(3) The rate at which interest shall accrue during each year shall be the rate which the secretary of state has certified as the annual interest rate under subsection (2) of this section.

Source: L. 82: Entire section added, p. 226, § 1, effective January 1, 1983. **L. 84:** (1) and (2) amended, p. 287, § 1, effective July 1.

ANNOTATION

Law reviews. For article, "Rates of Interest on State and Federal Court Judgments: An Update", see 12 Colo. Law. 446 (1983). For article, "Collecting Pre- and Post-Judgment Interest in Colorado: A Primer", see 15 Colo. Law. 753 (1986). For article, "An Update of Appendices from Collecting Pre- and Post-Judgment Interest in Colorado", see 15 Colo. Law. 990 (1986). For article, "Recovery of Interest: Parts I and II", see 18 Colo. Law. 1063 and 1307 (1989).

The right to interest, absent an agreement to pay it, is purely statutory, and is limited to those circumstances set forth in the statute. Indian Mountain Metro. Recreation & Park Dist. v. J.P. Campbell & Assoc., 921 P.2d 65 (Colo. App. 1996); Bd. of County Comm'rs of Dolores County v. Shell W. E & P, Inc., 12 P.3d 1219 (Colo. App. 2000).

Where there is no "judgment" entered in a "trial court" to which subsection (1) could apply, a claim for post-judgment interest pursuant to subsection (1) is properly rejected. Bd. of County Comm'rs of Dolores County v. Shell W. E & P, Inc., 12 P.3d 1219 (Colo. App. 2000).

Court cannot divide a single unsatisfied judgment into two or more parts for the purpose of computing interest. Bassett v. Eagle Telecomms., 750 P.2d 73 (Colo. App. 1987).

Interest is payable upon that portion of the judgment that is ultimately affirmed by the appellate court. Bassett v. Eagle Telecomms., 750 P.2d 73 (Colo. App. 1987); In re Gutfreund, 148 P.3d 136 (Colo. 2006).

A judgment confirming an arbitration award is enforceable in the same manner as any other judgment. Therefore, the district court did not err in ordering post-judgment interest on the unpaid portion of the judgment. Barrett v. Inv. Mgmt. Consultants, 190 P.3d 800 (Colo. App. 2008).

An appealing judgment debtor must pay post-judgment interest when the appeal is affirmed and the funds are inaccessible to the creditor; further, there is no requirement that interest must be specifically requested. This section makes no exception for attorney fees; post-judgment interest on attorney fees is required when the judgment is affirmed on appeal. Furthermore, it is of no import whether the judgment award for attorney fees is made directly to the attorney or to the party. In re Gutfreund, 148 P.3d 136 (Colo. 2006).

While the statute does not define "satisfaction", a party satisfies a debt when the creditor has been paid and the debtor is no longer obligated to pay that portion of the amount due. Thus, if debtor deposits the funds in a court registry, the judgment is not satisfied until the funds are accessible to the creditor, and only at that point does the obligation to pay interest terminate. In re Gutfreund, 148 P.3d 136 (Colo. 2006).

Appeal of judgment debtor is considered a single unsuccessful appeal for purposes of this section where judgment debtor insurer prevailed on appeal at the court of appeals but trial court's judgment was subsequently reinstated by the supreme court on appeal by the insured. Accordingly, insurer was required to pay post-judgment interest from the date of the original judgment in the trial court. Peterman v. State Farm Mut. Auto. Ins. Co., 8 P.3d 549 (Colo. App. 2000).

Because the trial court's failure to include an award of post-judgment interest was due to an oversight, it could amend the judgment at any time to add the award. Jennings v. Ibarra, 921 P.2d 62 (Colo. App. 1996).

An order entered by the public utilities commission is equivalent to a judgment by a trial court, and the interest on the award accrues from the date of entry of the commission order not the judgment of the district court. Lake Durango Water Co. v. Pub. Utils. Comm'n, 67 P.3d 12 (Colo. 2003).

This section does not apply to a situation covered by the prompt payment statute. To the extent there is a conflict, the more specific prompt payment statute prevails over this section. New Design Constr. Co. v. Hamon Contractors, Inc., 215 P.3d 1163 (Colo. App. 2008).

Applied in Weston v. Mincomp Corp., 698 P.2d 274 (Colo. App. 1985).

5-12-107. Commercial credit plans - definitions. (1) Any creditor may offer and extend credit to the debtor under a commercial credit plan. Without limitation, credit may be extended under a commercial credit plan by the creditor's acquisition of obligations including, without limitation, obligations arising out of the honoring by a seller or another person of a credit device made available to the debtor under a commercial credit plan. A creditor may take such security in connection with a commercial credit plan as may be acceptable to the creditor and may, if the agreement governing the commercial credit plan allows, establish separate accounts for different types of purchases or loans, or both, and impose different terms for credit extended with respect to each account.

(2) (a) A creditor may charge and collect periodic interest under a commercial credit plan on the outstanding unpaid indebtedness at a periodic percentage rate or rates not exceeding forty-five percent per annum. If the applicable periodic percentage rate under the agreement governing the plan is other than daily, periodic interest may be calculated on an amount not in excess of the average outstanding unpaid indebtedness for the applicable billing period. If the applicable periodic percentage rate under the agreement governing the plan is daily, periodic interest may be calculated for each day in the billing period on an amount not in excess of either:

(I) The outstanding unpaid indebtedness on that day; or

(II) The average outstanding unpaid indebtedness for the applicable billing period. If the applicable periodic percentage rate under the agreement governing the plan is monthly, a billing period shall be deemed to be a month or monthly if the last day of each billing period is on the same day of each month or does not vary by more than four days therefrom.

(b) The rate limitation established by this subsection (2) for periodic interest shall not apply to the additional interest charges authorized by subsection (3) of this section regardless of whether such additional interest charges are imposed in addition to or in lieu of periodic interest.

(3) (a) In addition to or in lieu of interest at a periodic rate or rates, a creditor may, if the agreement governing the commercial credit plan so provides, either initially or pursuant to a change in the terms of the agreement made in the manner prescribed by subsection (5) of this section, charge and collect, in such manner, form, percentages, or amounts as the agreement governing the plan may provide, one or more of the following fees or charges:

(I) A fee for participation in the commercial credit plan, whether assessed on an annual or other periodic basis;

(II) A transaction charge for each separate purchase or loan under the plan;

(III) An automated teller machine charge or similar electronic or interchange fee or charge;

(IV) A minimum charge for each scheduled billing period under the commercial credit plan during any portion of which there is an outstanding unpaid indebtedness;

(V) A late payment charge for each required payment not made on or before its scheduled due date;

(VI) Fees for services rendered or for reimbursement of expenses incurred by the creditor or other persons in connection with the commercial credit plan, or other fees incidental to the application, opening, administration, maintenance, or termination of a commercial credit plan;

(VII) Returned payment charges;

(VIII) Documentary evidence charges including without limitation charges for furnishing copies of sales slips, invoices, monthly statements, or other documents; and

(IX) Any similar fees or charges provided for in the agreement governing the commercial credit plan, whether initially or pursuant to a change in the terms of the agreement made in the manner prescribed by subsection (5) of this section; except that in no event shall this authorization to charge and collect any similar fees or charges be construed to authorize

the imposition of periodic interest on the outstanding unpaid indebtedness in addition to the periodic interest authorized by subsection (2) of this section.

(b) Notwithstanding the fact that they are not subject to the rate limitation established by subsection (2) of this section for periodic interest, all of the fees and charges permitted by this subsection (3) are interest.

(4) The agreement governing a commercial credit plan may provide for the payment by the debtor of reasonable attorney's fees of the creditor if the account of the debtor is referred for collection to an attorney not a salaried employee of the creditor. The agreement also may provide for the payment by the debtor of all court and other collection costs actually incurred by the debtor.

(5) (a) Upon written notice furnished at least fifteen days prior to the effective date of the change, a creditor may change the terms of the agreement governing the commercial credit plan including, without limitation, periodic interest and additional interest charges so long as the debtor does not, prior to the effective date of the change set forth in the notice, furnish written notice to the creditor that the debtor does not agree to abide by the change. The change may be made effective with respect to existing balances if so provided in the written notice.

(b) Upon receipt by the creditor of a timely written notice stating that the debtor does not agree to abide by the change, the debtor shall have the remainder of the time under the existing terms in which to pay all sums owed to the creditor as of the effective date of the change set forth in the notice. If there is an authorized charge to the account on or after the effective date of the change set forth in the notice, the debtor shall be deemed to have accepted the new terms even if the debtor previously submitted to the creditor a timely written notice stating that the debtor does not agree to abide by the change.

(6) All terms, conditions, and other provisions of and relating to a commercial credit plan as contained in this section or in the agreement governing such plan, other than those fees and charges that are interest under this section, shall be and hereby are deemed to be material to the determination of interest applicable to a commercial credit plan under Colorado law, under the most favored lender doctrine, and under the "National Bank Act", 12 U.S.C. sec. 85 or section 521, 522, or 523 of the "Depository Institutions Deregulation and Monetary Control Act of 1980", 12 U.S.C. secs. 1463 (g), 1785 (g), and 1831d.

(7) A commercial credit plan established by a creditor and the extensions of credit made pursuant thereto shall be governed by Colorado law. Unless the agreement governing the commercial credit plan expressly states that it is subject to another law of this state, a commercial credit plan shall be governed exclusively by this section and shall not be subject to any other law of this state that otherwise would apply to the commercial credit plan including, but not limited to, laws limiting the amount or duration of credit or the rate or amount of interest or other charges that may be charged, taken, collected, received, or reserved.

(8) As used in this section:

(a) "Average outstanding unpaid indebtedness" means the amount determined by dividing the total of the amounts of the outstanding unpaid indebtedness for each day in the applicable billing period by the number of days in the billing period.

(b) "Commercial credit plan" or "plan" means a plan contemplating the extension of credit pursuant to an account governed by an agreement between a creditor and a debtor, whether or not providing for a security interest, pursuant to which:

(I) A creditor permits the debtor and, if allowed by a creditor, persons acting on behalf of or with authorization from the debtor, from time to time to make purchases on credit or obtain loans, or both, whether or not by use of a credit device;

(II) The purchases on credit are made or the loans are obtained primarily for business, commercial, investment, or agricultural purposes;

(III) The indebtedness of the debtor arising from such purchases or loans, or both, and other charges provided for in this section are debited to the account; and

(IV) (A) The debtor undertakes an obligation to pay the outstanding unpaid indebtedness at one time; or

(B) The debtor has the privilege of paying the outstanding unpaid indebtedness in one or more installments.

(c) "Credit" means the right granted by a creditor to the debtor to defer payment of debt or to incur debt and defer its payment.

(d) "Credit device" means any card, check, identification code, account number, or other means of identification contemplated by the agreement governing the plan.

(e) "Creditor" means any seller or any lender located or maintaining a place of business in this state that enters into a commercial credit plan agreement with a debtor wherever located, including, without limitation, sellers of goods or services, small loan companies, licensed lenders, industrial banks, commercial banks and trust companies, savings and loan associations, and savings banks. The term "creditor" includes any transferee, whether such transferee acquires its interest by assignment or otherwise.

(f) "Debtor" means any natural person or individual or any corporation, partnership, cooperative, association, government or governmental subdivision or agency, trust, estate, or other entity.

(g) "Interest" includes both periodic interest authorized by subsection (2) of this section and additional interest charges authorized by subsection (3) of this section.

(h) "Loans" means cash advances or loans to be paid to or for the account of the debtor.

(i) "Outstanding unpaid indebtedness" means on any day an amount not in excess of the total amount of purchases, loans, and other debits charged to the debtor's account under the plan that is outstanding and unpaid at the end of the day, after adding the aggregate amount of any new purchases, loans, and other debits charged to the account as of that day, including, without limitation, the amount of any periodic interest, additional interest charges, and other charges permitted by this section that have accrued, or been charged, to the account as of that day, and deducting the aggregate amount of any payments and other credits applied to that indebtedness as of that day.

(j) "Purchases" means payment obligations for property of whatever nature, real or personal, tangible or intangible, and payment obligations for services including, without limitation, insurance, licenses, taxes, official fees, fines, private or governmental obligations, or any other thing of value.

Source: L. 96: Entire section added, p. 407, § 13, effective July 1.

ANNOTATION

Under federal law, a late payment fee is a form of "interest". Copeland v. MBNA Am. Bank, N.A., 907 P.2d 87 (Colo. 1995); Richardson v. Citibank (S.D.), N.A., 908 P.2d 532 (Colo. 1995); Smiley v. Citibank (S.D.), 517 U.S. 735, 116 S. Ct. 1730, 135 L. Ed. 2d 25 (1996).

ARTICLE 13

Federal Preemption of Usury Laws - State Override

Law reviews: For article, "An Update of Appendices from Collecting Pre- and Post-Judgment Interest in Colorado", see 15 Colo. Law. 990 (1986); for article, "Colorado Usury: The Sequel - Part I", see 23 Colo. Law. 565 (1994).

5-13-101. Mortgages. In accordance with section 501 (b) (2) of Public Law 96-221, it is declared that the state of Colorado does not want the provisions of subsection 501 (a) (1) of Public Law 96-221 removing the limits on the rate or amount of interest, discount points, finance charges, or other charges which may be charged, taken, received, or reserved with

respect to loans, mortgages, credit sales, and advances made to apply in this state. The rates established in articles 1 to 9 of this title shall control consumer credit transactions in the state of Colorado.

Source: L. 81: Entire article added, p. 399, § 1, effective July 1.

5-13-102. Business and agricultural loans. In accordance with section 512 of Public Law 96-221, it is declared that the state of Colorado does not want the provisions of section 511 of Public Law 96-221 setting interest rates and preempting state interest rates on business and agricultural loans to apply in this state. The rates established in articles 1 to 9 of this title shall control consumer credit transactions in the state of Colorado.

Source: L. 81: Entire article added, p. 399, § 1, effective July 1.

5-13-103. Small business loans. In accordance with section 524 of Public Law 96-221, it is declared that the state of Colorado does not want the amendments to the "Small Business Investment Act" made by section 524 of Public Law 96-221 prescribing interest rates for small business loans to apply in this state. The rates established in articles 1 to 9 of this title shall control consumer credit transactions in the state of Colorado.

Source: L. 81: Entire article added, p. 399, § 1, effective July 1.

5-13-104. Other loans. (Repealed)

Source: L. 81: Entire article added, p. 400, § 1, effective July 1. **L. 94:** Entire section repealed, p. 1612, § 12, effective July 1.

5-13-105. General override. (Repealed)

Source: L. 81: Entire article added, p. 400, § 1, effective July 1. **L. 94:** Entire section repealed, p. 1613, § 13, effective July 1.

TITLE 6

CONSUMER AND COMMERCIAL AFFAIRS

TITLE 6

CONSUMER AND COMMERCIAL AFFAIRS

FAIR TRADE AND RESTRAINT OF TRADE

ARTICLE 1

Colorado Consumer Protection Act

Law reviews: For article, "The Colorado Consumer Protection Act: An Update", see 29 Colo. Law. 37 (January 2000); for article, "The Law of Trade Secrecy and Covenants Not to Compete in Colorado - Part I", see 30 Colo. Law. 7 (April 2001); for article, "The Limitations of the Colorado Consumer Protection Act in Insurance Bad Faith Litigation", see 34 Colo. Law. 75 (November 2005); for article, "Managing Risks Associated With Attorney Advertising", see 36 Colo. Law. 63 (April 2007); for comment, "Opening the Door: Crow v. Tull and the Application of the Colorado Consumer Protection Act to Attorneys", 79 U. Colo. L. Rev. 295 (2008).

PART 1

CONSUMER PROTECTION - GENERAL

Law reviews: For article, "The Showpiece Homes Decision: From Caveat Emptor to Insurer Beware?", see 31 Colo. Law. 73 (April 2002).

6-1-101. Short title. This article shall be known and may be cited as the "Colorado Consumer Protection Act".

Source: L. 69: p. 376, § 13. **C.R.S. 1963:** § 55-5-13.

ANNOTATION

Law reviews. For note, "Implied Warranties — Sales of Used Cars in Colorado", see 42 U. Colo. L. Rev. 473 (1971). For article, "Federal Practice and Procedure", see 57 Den. L.J. 263 (1980). For comment, "Antitrust Law in Colorado: Back on Track", see 60 Den. L.J. 645 (1983). For article, "Franchise Regulation", see 15 Colo. Law. 395 (1986). For article, "Antitrust Law", which discusses Tenth Circuit decisions dealing with antitrust law, see 64 Den. U.L. Rev. 131 (1987).

The general assembly acted well within the police power of the state when it enacted the Colorado Consumer Protection Act. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

It is in the public interest to invoke the state's police power to prevent the use of methods that have a tendency or capacity to attract customers through deceptive trade practices, and the Colorado Consumer Protection Act, an out-growth of this conclusion, as such cannot be overturned. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

Hence, a challenging party has a heavy burden to overcome with respect to this act's alleged unconstitutionality, especially in light of its particular subject matter. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

A court has an equally certain duty to construe the act in such a way that it is not

void for vagueness whenever a reasonable and practical construction can be given to its language. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

Broad legislative purpose of this act is to provide prompt, economical, and readily available remedies against consumer fraud. W. Food Plan, Inc. v. District Court, 198 Colo. 251, 598 P.2d 1038 (1979).

"Public impact" necessary to invoke protections of act. In a case involving life insurance, where challenged conduct of insurer was private in nature, policyholder was a sophisticated businessman with the aid of legal counsel, and there was insufficient evidence of impact on other policyholders, the treble damages provisions of the Colorado Consumer Protection Act were held not to apply. Coors v. Sec. Life of Denver Ins. Co., 112 P.3d 59 (Colo. 2005).

A private cause of action by an insured against an insurer under this act is not preempted by the Colorado unfair competition - deceptive practices act §§ 10-3-1101 to 10-3-1114. Showpiece Homes Corp. v. Assurance Co. of Am., 38 P.3d 47 (Colo. 2001).

This act is remedial legislation and amendment of remedies therein does not affect preexisting rights or obligations. Therefore, amended version of act containing enhanced civil enforcement provisions could be applied to conduct which occurred prior to amendments. Robinson v. Lynmar Racquet Club, Inc., 851 P.2d 274 (Colo. App. 1993).

6-1-102. Definitions. As used in this article, unless the context otherwise requires:

(1) "Advertisement" includes the attempt by publication, dissemination, solicitation, or circulation, visual, oral, or written, to induce directly or indirectly any person to enter into any obligation or to acquire any title or interest in any property.

(2) "Article" means a product as distinguished from a trademark, label, or distinctive dress in packaging.

(2.5) "Business day" means any calendar day except Sunday, New Year's day, the third Monday in January observed as the birthday of Dr. Martin Luther King, Jr., Washington-Lincoln day, Memorial day, Independence day, Labor day, Columbus day, Veterans' day, Thanksgiving, and Christmas.

(2.7) "Buyers' club" means any person engaged in advertising or selling memberships that provide an exclusive right to members to purchase goods, food, services, or property at purported discount prices.

(3) "Certification mark" means a mark used in connection with the goods or services of a person other than the certifier to indicate geographic origin, material, mode of manufacture, quality, accuracy, or other characteristics of the goods or services or to indicate that the work or labor on the goods or services was performed by members of a union or other organization.

(4) "Collective mark" means a mark used by members of a cooperative, association, or other collective group or organization to identify goods or services and distinguish them from those of others, or to indicate membership in the collective group or organization.

(4.1) "Dance studio" means any person engaged in the advertisement or sale of dance studio services.

(4.2) "Dance studio services" means instruction, training, or assistance in dancing; the use of dance studio facilities; membership in any group, club, or association formed by a dance studio; and participation in dance competitions, dance showcases, trips, tours, parties, and other organized events and related travel arrangements.

(4.3) "Discount health plan" means a program evidenced by a membership agreement, contract, card, certificate, device, or mechanism, which offers health care services, as defined in section 10-16-102 (22), C.R.S., or related products including, but not limited to, prescription drugs and medical equipment, at purported discounted rates from health care providers advertised as participating in the program. A "discount health plan" does not include a program in which a participating provider has agreed, as a condition of his or her participation in the program, to negotiate the prices to be charged for his or her services directly with consumers in the program and the provider is not required to offer discounted prices for his or her services as part of the program.

(4.4) "Elderly person" means a person sixty years of age or older.

(4.5) "Food" means any raw, cooked, or processed edible substance, beverage, or ingredient used or intended for use or for sale in whole or part for human consumption.

(4.6) "Health club" means an establishment which provides health club services or facilities which purport to improve or maintain the user's physical condition or appearance

through exercise. The term may include, but shall not be limited to, a spa, exercise club, exercise gym, health studio, or playing courts. The term shall not apply to any of the following:

(a) Any establishment operated by a nonprofit organization or public or private school, college, or university;

(b) Any establishment operated by the federal government, the state of Colorado, or any of the state's political subdivisions;

(c) Any establishment which does not provide health club services or facilities as its primary purpose or business; or

(d) Health care facilities licensed or certified by the department of public health and environment pursuant to its authority under section 25-1.5-103, C.R.S.

(4.7) "Health club facilities" means equipment, physical structures, and other tangible property utilized by a health club to conduct its business. The term may include, but shall not be limited to, saunas, whirlpool baths, gymnasiums, running tracks, playing courts, swimming pools, shower areas, and exercise equipment.

(4.8) "Health club services" means services, privileges, or rights offered for sale or provided by a health club.

(4.9) "Manufactured home" shall have the same meaning as set forth in section 42-1-102 (106) (b), C.R.S.

(5) "Mark" means a word, name, symbol, device, or any combination thereof in any form or arrangement.

(5.5) "Motor vehicle" shall have the same meaning as set forth in section 12-6-102 (12), C.R.S.

(6) "Person" means an individual, corporation, business trust, estate, trust, partnership, unincorporated association, or two or more thereof having a joint or common interest, or any other legal or commercial entity.

(7) "Promoting a pyramid promotional scheme" means inducing one or more other persons to become participants, or attempting to so induce, or assisting another in promoting a pyramid promotional scheme by means of references or otherwise.

(8) "Property" means any real or personal property, or both real and personal property, intangible property, or services.

(9) "Pyramid promotional scheme" means any program utilizing a pyramid or chain process by which a participant in the program gives a valuable consideration in excess of fifty dollars for the opportunity or right to receive compensation or other things of value in return for inducing other persons to become participants for the purpose of gaining new participants in the program. Ordinary sales of goods or services to persons who are not purchasing in order to participate in such a scheme are not within this definition.

(10) "Sale" means any sale, offer for sale, or attempt to sell any real or personal property for any consideration.

(11) "Service mark" means a mark used by a person to identify services and to distinguish them from the services of others.

(11.2) Repealed.

(11.5) "Time share" means a time share estate, as defined in section 38-33-110 (5), C.R.S., a time share use, as defined in section 12-61-401 (4), C.R.S., or any campground or recreational membership which does not constitute the transfer of an interest in real property.

(12) "Trademark" means a mark used by a person to identify goods and to distinguish them from the goods of others.

(13) "Trade name" means a word, name, symbol, device, or any combination thereof in any form or arrangement used by a person to identify his business, vocation, or occupation, and to distinguish it from the business, vocation, or occupation of others.

(13.5) "Unavoidable delay" means inclement weather and other events outside the control of the buyer or seller.

(14) "Used motor vehicle" shall have the same meaning as set forth in section 42-6-201 (8), C.R.S.

Source: L. 69: p. 371, § 1. **C.R.S. 1963:** § 55-5-1. **L. 73:** p. 619, § 1. **L. 84:** (4.5) and (11.5) added, pp. 289, 290, §§ 1, 1, effective July 1. **L. 85:** (4.6) to (4.8) added, p. 306, § 1, effective June 1. **L. 87:** (2.5) added and (9), (10), and (11.5) amended, p. 356, § 1, effective July 1. **L. 88:** (4.2) and (4.3) added, p. 341, § 1, effective July 1. **L. 90:** (2.7) and (11.2) added, p. 380, § 1, effective July 1. **L. 92:** (5.5) and (14) added, p. 1835, § 1, effective April 29. **L. 93:** (11.2) repealed, p. 943, § 1, effective July 1. **L. 94:** (4.6)(d) amended, p. 2721, § 310, effective July 1. **L. 98:** (4.9) and (13.5) added, p. 746, § 1, effective August 5. **L. 2000:** (2.7) amended, p. 244, § 1, effective March 30; (4.4) added, p. 1107, § 1, effective August 2. **L. 2003:** (4.6)(d) amended, p. 699, § 3, effective July 1. **L. 2004:** (4.1) added and (4.2) and (4.3) amended, p. 967, § 7, effective May 21.

Cross references: For the "Colorado Charitable Solicitations Act", see article 16 of this title.

ANNOTATION

Law reviews. For article, "Criminal Prosecutions under the Colorado Securities Act", see 47 U. Colo. L. Rev. 233 (1976). For article, "Legal Aspects of Health and Fitness Clubs: A Healthy and Dangerous Industry", see 15 Colo. Law. 1787 (1986).

The Colorado general assembly omitted the definition of "advertise", recognizing that definitions in statutes should be limited to the fewest number of words and phrases possible, and that there is no need for a redefinition of terms. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

So meaning of "advertise" determined by reference to "advertisement". Statutes must be construed as a whole, and the several parts of a statute reflect light upon each other, so in this section the meaning of "advertise" can and must be determined by reference to the definition of "advertisement". People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

For the word "advertise" is but the verbal form of the noun "advertisement", so what the statutory definition of the noun encompasses must by common sense apply to the verbal form of the noun when used in the same statute. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

Advertisement or sale of real property covered. Read together, the definitions in subsections (1), (8) and (10) indicate an intent by the general assembly to extend the coverage of the Consumer Protection Act to transactions involving the advertisement or sale of real property. People ex rel. MacFarlane v. Alpert Corp., 660 P.2d 1295 (Colo. App. 1982).

Similarly, although the Colorado Consumer Protection Act does not specifically define "disparagement" anywhere, the word has such a common meaning that to define it would be an exercise in redundancy, since legal literature contains many instances of the use of the word "disparagement" when dealing with forbidden trade practices. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

If a claim by a corporation is within the zone of interests of the Colorado Consumer Protection Act, a corporation is a person entitled to bring a claim under the Act. Fiberglass Component Prod. v. Reichhold Chems., Inc., 983 F. Supp. 948 (D. Colo. 1997).

The definition of "person" is broad enough to encompass insurance companies. Thus, by its own terms, the Colorado Consumer Protection Act applies to the acts or practices of insurance companies. Showpiece Homes Corp. v. Assurance Co. of Am., 38 P.3d 47 (Colo. 2001).

"Pyramid promotional scheme". A pyramid sales scheme is no less a security because of the sale of distributorships where what, in essence, was being offered was an opportunity to contribute money and to share in the profits of an enterprise managed and owned by Master Industries. Sauer v. Hays, 36 Colo. App. 190, 539 P.2d 1343 (1975).

Although pyramid promotional schemes as defined in subsection (9) are not specifically included within the securities act, that statutory prohibition is indicative of the attitude of the general assembly to schemes of that nature. Sauer v. Hays, 36 Colo. App. 190, 539 P.2d 1343 (1975).

Promoters of pyramid promotional plans must make full, complete, and fair disclosure, through the registration statement, of the perils involved before their prospects invest their money. Sauer v. Hays, 36 Colo. App. 190, 539 P.2d 1343 (1975).

A pyramid promotional scheme involved an "investment contract", a "common enterprise" whereby the "fortunes of the investors" were "inextricably tied" and dependent upon the efforts and success of the corporation in obtaining and recruiting new prospects for its seminars and in consummating sales, and constituted the sale of securities in violation of Colorado's securities act. Sauer v. Hays, 36 Colo. App. 190, 539 P.2d 1343 (1975).

6-1-103. Attorney general and district attorneys concurrently responsible for enforcement. The attorney general and the district attorneys of the several judicial districts of this state are concurrently responsible for the enforcement of this article. Until the Colorado supreme court adopts a venue provision relating to this article, actions instituted pursuant to this article may be brought in the county where an alleged deceptive trade practice occurred or where any portion of a transaction involving an alleged deceptive trade practice occurred, or in the county where the principal place of business of any defendant is located, or in the county in which any defendant resides.

Source: L. 69: p. 376, § 11. **C.R.S. 1963:** § 55-5-11. **L. 73:** p. 620, § 4. **L. 77:** Entire section R&RE, p. 348, § 1, effective July 1. **L. 87:** Entire section amended, p. 357, § 2, effective July 1.

ANNOTATION

Applied in Barreras v. People, 636 P.2d 686 (Colo. 1981).

6-1-104. Cooperative reporting. The district attorneys may cooperate in a statewide reporting system by receiving, on forms provided by the attorney general, complaints from persons concerning deceptive trade practices listed in section 6-1-105 and part 7 of this article and transmitting such complaints to the attorney general.

Source: L. 69: p. 376, § 10. **C.R.S. 1963:** § 55-5-10. **L. 73:** p. 619, § 3. **L. 77:** Entire section R&RE, p. 348, § 2, effective July 1. **L. 86:** Entire section amended, p. 445, § 2, effective April 17. **L. 99:** Entire section amended, p. 652, § 4, effective May 18.

6-1-105. Deceptive trade practices. (1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person:

(a) Knowingly passes off goods, services, or property as those of another;

(b) Knowingly makes a false representation as to the source, sponsorship, approval, or certification of goods, services, or property;

(c) Knowingly makes a false representation as to affiliation, connection, or association with or certification by another;

(d) Uses deceptive representations or designations of geographic origin in connection with goods or services;

(e) Knowingly makes a false representation as to the characteristics, ingredients, uses, benefits, alterations, or quantities of goods, food, services, or property or a false representation as to the sponsorship, approval, status, affiliation, or connection of a person therewith;

(f) Represents that goods are original or new if he knows or should know that they are deteriorated, altered, reconditioned, reclaimed, used, or secondhand;

(g) Represents that goods, food, services, or property are of a particular standard, quality, or grade, or that goods are of a particular style or model, if he knows or should know that they are of another;

(h) Disparages the goods, services, property, or business of another by false or misleading representation of fact;

(i) Advertises goods, services, or property with intent not to sell them as advertised;

(j) Advertises goods or services with intent not to supply reasonably expectable public demand, unless the advertisement discloses a limitation of quantity;

(k) Advertises under the guise of obtaining sales personnel when in fact the purpose is to first sell a product or service to the sales personnel applicant;

(l) Makes false or misleading statements of fact concerning the price of goods, services, or property or the reasons for, existence of, or amounts of price reductions;

(m) Fails to deliver to the customer at the time of an installment sale of goods or services a written order, contract, or receipt setting forth the name and address of the seller,

the name and address of the organization which he represents, and all of the terms and conditions of the sale, including a description of the goods or services, stated in readable, clear, and unambiguous language;

(n) Employs "bait and switch" advertising, which is advertising accompanied by an effort to sell goods, services, or property other than those advertised or on terms other than those advertised and which is also accompanied by one or more of the following practices:

(I) Refusal to show the goods or property advertised or to offer the services advertised;

(II) Disparagement in any respect of the advertised goods, property, or services or the terms of sale;

(III) Requiring tie-in sales or other undisclosed conditions to be met prior to selling the advertised goods, property, or services;

(IV) Refusal to take orders for the goods, property, or services advertised for delivery within a reasonable time;

(V) Showing or demonstrating defective goods, property, or services which are unusable or impractical for the purposes set forth in the advertisement;

(VI) Accepting a deposit for the goods, property, or services and subsequently switching the purchase order to higher-priced goods, property, or services; or

(VII) Failure to make deliveries of the goods, property, or services within a reasonable time or to make a refund therefor;

(o) Knowingly fails to identify flood-damaged or water-damaged goods as to such damages;

(p) Solicits door-to-door as a seller, unless the seller, within thirty seconds after beginning the conversation, identifies himself or herself, whom he or she represents, and the purpose of the call;

(p.3) to (p.7) Repealed.

(q) Contrives, prepares, sets up, operates, publicizes by means of advertisements, or promotes any pyramid promotional scheme;

(r) Advertises or otherwise represents that goods or services are guaranteed without clearly and conspicuously disclosing the nature and extent of the guarantee, any material conditions or limitations in the guarantee which are imposed by the guarantor, the manner in which the guarantor will perform, and the identity of such guarantor. Any representation that goods or services are "guaranteed for life" or have a "lifetime guarantee" shall contain, in addition to the other requirements of this paragraph (r), a conspicuous disclosure of the meaning of "life" or "lifetime" as used in such representation (whether that of the purchaser, the goods or services, or otherwise). Guarantees shall not be used which under normal conditions could not be practically fulfilled or which are for such a period of time or are otherwise of such a nature as to have the capacity and tendency of misleading purchasers or prospective purchasers into believing that the goods or services so guaranteed have a greater degree of serviceability, durability, or performance capability in actual use than is true in fact. The provisions of this paragraph (r) apply not only to guarantees but also to warranties, to disclaimer of warranties, to purported guarantees and warranties, and to any promise or representation in the nature of a guarantee or warranty; however, such provisions do not apply to any reference to a guarantee in a slogan or advertisement so long as there is no guarantee or warranty of specific merchandise or other property.

(s) and (t) Repealed.

(u) Fails to disclose material information concerning goods, services, or property which information was known at the time of an advertisement or sale if such failure to disclose such information was intended to induce the consumer to enter into a transaction;

(v) Disburses funds in connection with a real estate transaction in violation of section 38-35-125 (2), C.R.S.;

(w) Repealed.

(x) Violates the provisions of sections 6-1-203 to 6-1-205 or of part 7 of this article;

(y) Fails, in connection with any solicitation, oral or written, to clearly and prominently disclose immediately adjacent to or after the description of any item or prize to be received by any person the actual retail value of each item or prize to be awarded. For the purposes of this paragraph (y), the actual retail value is the price at which substantial sales of the item were made in the person's trade area or in the trade area in which the item or prize is to be

received within the last ninety days or, if no substantial sales were made, the actual cost of the item or prize to the person on whose behalf any contest or promotion is conducted; except that, whenever the actual cost of the item to the provider is less than fifteen dollars per item, a disclosure that "actual cost to the provider is less than fifteen dollars" may be made in lieu of disclosure of actual cost. The provisions of this paragraph (y) shall not apply to a promotion which is soliciting the sale of a newspaper, magazine, or periodical of general circulation, or to a promotion soliciting the sale of books, records, audio tapes, compact discs, or videos when the promoter allows the purchaser to review the merchandise without obligation for at least seven days and provides a full refund within thirty days after the receipt of the returned merchandise or when a membership club operation is in conformity with rules and regulations of the federal trade commission contained in 16 CFR 425.

(z) Refuses or fails to obtain all governmental licenses or permits required to perform the services or to sell the goods, food, services, or property as agreed to or contracted for with a consumer;

(aa) Fails, in connection with the issuing, making, providing, selling, or offering to sell of a motor vehicle service contract, to comply with the provisions of article 11 of title 42, C.R.S.;

(bb) Repealed.

(cc) Engages in any commercial telephone solicitation which constitutes an unlawful telemarketing practice as defined in section 6-1-304;

(dd) Repealed.

(ee) Intentionally violates any provision of article 10 of title 5, C.R.S.;

(ee.5) to (ff) Repealed.

(gg) Fails to disclose or misrepresents to another person, a secured creditor, or an assignee by whom such person is retained to repossess personal property whether such person is bonded in accordance with section 4-9-629, C.R.S., or fails to file such bond with the attorney general;

(hh) Violates any provision of article 16 of this title;

(ii) Repealed.

(jj) Represents to any person that such person has won or is eligible to win any award, prize, or thing of value as the result of a contest, promotion, sweepstakes, or drawing, or that such person will receive or is eligible to receive free goods, services, or property, unless, at the time of the representation, the person has the present ability to supply such award, prize, or thing of value;

(kk) Violates any provision of article 6 of this title;

(ll) Knowingly makes a false representation as to the results of a radon test or the need for radon mitigation;

(mm) Violates section 35-27-113 (3) (e), (3) (f), or (3) (i), C.R.S.;

(nn) Repealed.

(oo) Fails to comply with the provisions of section 35-80-108 (1) (a), (1) (b), or (2) (f), C.R.S.;

(pp) Violates article 9 of title 42, C.R.S.;

(qq) Repealed.

(rr) Violates the provisions of part 8 of this article;

(ss) Violates any provision of part 33 of article 32 of title 24, C.R.S., that applies to the installation of manufactured homes;

(tt) Violates any provision of part 9 of this article;

(uu) Violates section 38-40-105, C.R.S.;

(vv) Violates section 12-55-110.3, C.R.S.;

(ww) Violates any provision of section 6-1-702;

(xx) Violates any provision of part 11 of this article;

(yy) Violates any provision of part 3 of article 5.5 of title 12, C.R.S.;

(zz) Violates any provision of section 6-1-717;

(aaa) Violates any provision of section 12-61-904.5, C.R.S.;

(bbb) Violates any provision of section 12-61-911, C.R.S.;

(ccc) Violates the provisions of section 6-1-722.

(2) Evidence that a person has engaged in a deceptive trade practice shall be prima facie evidence of intent to injure competitors and to destroy or substantially lessen competition.
(3) The deceptive trade practices listed in this section are in addition to and do not limit the types of unfair trade practices actionable at common law or under other statutes of this state.

Source: L. 69: p. 372, § 2. **C.R.S. 1963:** § 55-5-2. **L. 71:** p. 580, § 1. **L. 73:** p. 619, § 2. **L. 75:** (1)(r) added, p. 259, § 1, effective July 1. **L. 84:** (1)(e) and (1)(g) amended and (1)(s) added, pp. 289, 290, §§ 2, 2, effective July 1. **L. 85:** (1)(t) added, p. 307, § 2, effective June 1. **L. 87:** (1)(a), (1)(b), (1)(e), (1)(g) to (1)(i), and (1)(l) amended and (1)(s)(V) and (1)(u) added, p. 357, §§ 3, 4, effective July 1. **L. 88:** (1)(n) amended and (1)(v) and (1)(w) added, pp. 341, 1260, §§ 2, 2, effective July 1. **L. 89:** (1)(s)(V) repealed and (1)(y), (1)(z), and (1)(aa) added, pp. 360, 357, §§ 4, 1, effective July 7; (1)(x) added, p. 363, § 2, effective January 1, 1990. **L. 90:** (1)(ee) added, p. 378, § 2, effective April 20; (1)(t)(VI) amended and (1)(bb) to (1)(dd) added, p. 380, § 2, effective July 1. **L. 91:** (1)(t)(VI) amended and (1)(t)(VII) added, p. 329, § 1, effective May 16; (1)(dd)(I) amended and (1)(dd)(I.5) added, p. 331, § 1, effective June 8. **L. 92:** IP(1) amended and (1)(ff) added, p. 1835, § 2, effective April 29; IP(1) amended and (1)(gg) added, p. 247, § 2, effective June 1. **L. 93:** (1)(t)(VI) and (1)(y) amended and (1)(hh) to (1)(ll) added, p. 1571, § 1, effective July 1; (1)(cc) amended, p. 943, § 2, effective July 1; (1)(mm) added, p. 1022, § 3, effective July 1. **L. 94:** (1)(nn) added, p. 759, § 1, effective April 20; (1)(ee.5) added, p. 94, § 1, effective July 1; (1)(oo) added, p. 1311, § 10, effective July 1; (1)(aa) and (1)(ii) amended, p. 2544, § 14, effective January 1, 1995. **L. 96:** (1)(p) amended and (1)(p.3) and (1)(ee.7) added, pp. 787, 1787, §§ 1, 1, effective July 1. **L. 97:** (1)(pp) added, p. 865, § 13, effective May 21; (1)(p.5) and (1)(p.7) added, p. 500, § 1, effective July 1; (1)(ee.8) added, p. 406, § 1, July 1. **L. 98:** (1)(qq) added, p. 746, § 2, effective August 5. **L. 99:** (1)(p.3), (1)(p.5), (1)(p.7), (1)(s), (1)(t), (1)(w), (1)(bb), (1)(dd), (1)(ee.5), (1)(ee.7), (1)(ee.8), (1)(ff), (1)(ii), and (1)(qq) repealed and (1)(x) amended, pp. 655, 652, §§ 14, 3, effective May 18; (1)(qq) amended, p. 897, § 2, effective October 1. **L. 2000:** (1)(rr) added, p. 867, § 2, effective August 2; (1)(nn)(II) added by revision, pp. 2, 3, §§ 1, 6; (1)(ss) added, p. 1162, § 3, effective July 1, 2001. **L. 2001:** (1)(gg) amended, p. 1445, § 37, effective July 1; (1)(tt) added, p. 1461, § 2, effective August 8. **L. 2002:** (1)(uu) added, p. 1602, § 3, effective June 7. **L. 2003:** (1)(ss) amended, p. 550, § 3, effective March 5. **L. 2004:** (1)(vv) added, p. 181, § 2, effective July 1; (1)(ww) added, p. 407, § 2, effective August 4. **L. 2006:** (1)(xx) added, p. 1344, § 2, effective May 30. **L. 2007:** (1)(zz) added, p. 1728, § 5, effective June 1; (1)(aaa) and (1)(bbb) added, p. 1723, § 10, effective June 1; (1)(yy) added, p. 809, § 1, effective July 1. **L. 2010:** (1)(ccc) added, (SB 10-155), ch. 180, p. 648, § 2, effective August 11.

Editor's note: (1) Subsection (1)(dd)(I)(F) provided for the repeal of subsection (1)(dd)(I)(F), effective July 1, 1994. (See L. 91, p. 331.) Subsection (1)(nn)(II) provided for the repeal of subsection (1)(nn), effective July 1, 2001. (See L. 2000, p. 3.)
(2) (a) Subsections (1)(p.3), (1)(p.5), (1)(p.7), (1)(s), (1)(t), (1)(w), (1)(bb), (1)(dd), (1)(ee.5), (1)(ee.7), (1)(ee.8), (1)(ff), (1)(ii), and (1)(qq) were repealed and relocated in 1999 to part 7 of this article.
(b) Subsection (1)(qq) as amended by House Bill 99-1270 was harmonized with Senate Bill 99-143 and relocated to § 6-1-709, effective October 1, 1999.
(3) Subsection (1)(ww) was originally lettered as (1)(vv) in House Bill 04-1125, but has been relettered on revision for ease of location.

ANNOTATION

Law reviews. For article discussing remedies available for deceptive trade practices involving the misappropriation and use of a trade secret, see 48 U. Colo. L. Rev. 189 (1977). For article, "Franchise Regulation", see 15 Colo. Law. 395 (1986). For article, "Commercial Law", which discusses Tenth Circuit decisions dealing with questions of commercial law, see 63 Den. U.L. Rev. 225 (1986). For article, "Legal Aspects of Health and Fitness Clubs: A Healthy and Dangerous Industry", see 15 Colo. Law. 1787 (1986). For article, "Representing the Franchi-

see", see 18 Colo. Law. 2105 (1989). For article, "Default Judgments Against Consumers: Has the System Failed?", see 67 Den. U. L. Rev. 357 (1990). For article, "Regulating Faxing Activity Under State and Federal Law", see 34 Colo. Law. 63 (December 2005).

To prove a private cause of action under the Colorado Consumer Protection Act (CCPA), a plaintiff must show that: (1) The defendant engaged in an unfair or deceptive trade practice; (2) the challenged practice occurred in the course of defendant's business, vocation, or occupation; (3) it significantly impacts the public as actual or potential consumers of the defendant's goods, services, or property; (4) the plaintiff suffered injury in fact to a legally protected interest; and (5) the challenged practice caused the plaintiff's injury. Rhino Linings USA, Inc. v. Rocky Mountain Rhino Lining, Inc., 62 P.3d 142 (Colo. 2003); Nobody in Particular Presents, Inc. v. Clear Channel Commc'ns, Inc., 311 F. Supp. 2d (D. Colo. 2004).

Whether a private cause of action significantly impacts the public as actual or potential consumers of the defendant's goods, services, or property is a question of fact to be resolved by the trier of fact, and not an issue of law. One Creative Place, LLC v. Jet Ctr. Partners, LLC, 259 P.3d 1287 (Colo. App. 2011).

A deceptive trade practice claim concerning a utility's alleged misrepresentations about the heating content of natural gas is within the public utilities commission's exclusive jurisdiction because the commission explicitly considers the heating content of natural gas when setting rates, and the plaintiff's failure to exhaust its administrative remedies mandates dismissal of the claim. City of Aspen v. Kinder Morgan, Inc., 143 P.3d 1076 (Colo. App. 2006).

The list of deceptive trade practices in this section is not exhaustive and, because deceptive or unfair practices in the business of insurance could clearly injure the public, they are within the purview of the CCPA. Showpiece Homes Corp. v. Assurance Co. of Am., 38 P.3d 47 (Colo. 2001).

"Person", as used in this section, includes business corporations. Heller v. Lexton-Ancira Real Estate Fund, 809 P.2d 1016 (Colo. App. 1990).

The inclusion of the term "vocation" indicates that professionals may be held accountable under the CCPA. Crowe v. Tull, 126 P.3d 196 (Colo. 2006).

"Knowingly", as used in the CCPA, requires actual knowledge, not constructive knowledge. While some CCPA provisions enumerate violations where the person committing the deceptive trade practice "knows or should know" of the misrepresentation, other provisions require only that the person commits the trade practice "knowingly"; in the latter case, the legislature intended that actual knowledge is required to find a CCPA violation. People ex rel. Suthers v. Mandatory Poster, 260 P.3d 9 (Colo. App. 2009).

"Passing off", as used in this section, is sufficiently plain in its meaning and does not require a special jury instruction. Heller v. Lexton-Ancira Real Estate Fund, 809 P.2d 1016 (Colo. App. 1990).

For purposes of showing that a defendant knowingly makes a "false representation", the representation must either induce a party to act, refrain from acting, or have the capacity or tendency to attract customers. Rhino Linings USA, Inc. v. Rocky Mountain Rhino Lining, Inc., 62 P.3d 142 (Colo. 2003).

A plaintiff must establish not only that the defendant engaged in a deceptive trade practice but also that the defendant's challenged practice significantly impacts the public as actual or potential consumers of the defendant's goods, services, or property. To make this determination, relevant considerations include the number of consumers directly affected by the challenged practice, the relative sophistication and bargaining power of the consumers affected by the challenged practice, and evidence that the challenged practice has previously impacted other consumers or has the significant potential to do so in the future. Rhino Linings USA, Inc. v. Rocky Mountain Rhino Lining, Inc., 62 P.3d 142 (Colo. 2003).

Test applied in Colo. Coffee Bean v. Peaberry Coffee, 251 P.3d 9 (Colo. App. 2010).

Whether a private cause of action significantly impacts the public as actual or potential consumers of the defendant's goods, services, or property is a question of fact to be resolved by the trier of fact, and not an issue of law. One Creative Place, LLC v. Jet Ctr. Partners, LLC, 259 P.3d 1287 (Colo. App. 2011).

Disclosure may eliminate an otherwise deceptive trade practice. Where a company that published posters with incorrect information about Colorado labor and employment laws included a disclosure that the documents were not generated by the government, the trial court did not err in finding that the posters, as a whole, were not deceptive. People ex rel. Suthers v. Mandatory Poster, 260 P.3d 9 (Colo. App. 2009).

A promise of territorial exclusivity in a dealership agreement did not constitute a false representation absent a finding of fact that the company did not intend to honor its promise at the time the contract was executed. Rhino Linings USA, Inc. v. Rocky Mountain Rhino Lining, Inc., 62 P.3d 142 (Colo. 2003).

False representation as to the use or benefits of services, such as recommending an automotive fuel injector flush as a routine preventive maintenance service, violates this section.

Jones v. Stevinson's Golden Ford, 36 P.3d 129 (Colo. App. 2001).

Where a business first advertises a product at a very attractive price in order to invite inquiry, then disparages or "knocks" the product when members of the public make inquiry, and finally offers another item for sale which is more expensive than the first but which seems like a "bargain" in comparison to the disparaged product that was originally advertised, such practice constitutes deceptive use of advertising as a lure to sell other nonadvertised products or services which is exactly the kind of trade practice which the CCPA prohibits. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

Such "bait and switch" advertising and selling techniques have long been recognized in the legal literature and have long been subject to equitable sanctions. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

Likewise, the concept of a "tie-in sale" is not new to the law, as its practice has long been prohibited by the anti-trust laws. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

The fact that a "tie-in sale", like "disparagement", and "bait and switch" tactics is not a new or unfamiliar term to most business enterprises leads to the conclusion that its use in the CCPA does establish a standard against which one's business and trade activities can be tested, with a definite background of experience and precedent to illuminate the meaning of the words employed in the statute. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

General assembly intended the deceptive trade practice of bait and switch advertising to include the element of intent to deceive. Gen. Steel Domestic Sales, LLC v. Hogan & Hartson, LLP, 230 P.3d 1275 (Colo. App. 2010).

Advertisement or sale of real property covered. The general assembly has included sales and advertisements respecting real property in its broad but undefined use of the term "services" in subsections (1)(e), (g), (i), and (l), which makes false or misleading statements in the advertisement or sale of real property subject to the provisions of the CCPA. People ex rel. MacFarlane v. Alpert Corp., 660 P.2d 1295 (Colo. App. 1982).

The CCPA does not, as a matter of law, make actionable a statement that would otherwise be mere puffery. Park Rise Homeowners Ass'n, Inc. v. Res. Const. Co., 155 P.3d 427 (Colo. App. 2006); Alpine Bank v. Hubbell, 555 F.3d 1097 (10th Cir. 2009).

The sale of insurance can be classified as a sale of goods, services, or property and is thus subject to the provisions of the CCPA. Showpiece Homes Corp. v. Assurance Co. of Am., 38 P.3d 47 (Colo. 2001).

The implantation of an embryo is not a sale of a good or product; rather it constitutes the provision of a medical service pursuant to § 13-22-104. Am. Econ. Ins. Co. v. Schoolcraft, 551 F. Supp. 2d 1235 (D. Colo. 2007).

A violation of § 10-3-1104 does not constitute a per se violation of this section. This section creates a private right of action whereas § 10-3-1104 does not. Coors v. Sec. Life of Denver Ins. Co., 91 P.3d 393 (Colo. App. 2003), aff'd by operation of law, 112 P.3d 59 (Colo. 2005).

The CCPA is applicable to an insurer's post-sale unfair or bad faith conduct. Showpiece Homes Corp. v. Assurance Co. of Am., 38 P.3d 47 (Colo. 2001).

Attorneys may be found liable for CCPA violations. The proper test for CCPA liability is whether or not an attorney's conduct constitutes a deceptive trade practice with the requisite intent and meets the elements of public impact and causation. The CCPA applies to protect the vulnerable consumer of legal services and the consumer public as a whole in the situation in which the purveyor of those services knowingly misrepresents the quality and likely benefit of those services. Crowe v. Tull, 126 P.3d 196 (Colo. 2006).

Setting the price of an item so high that the market analysis shows that very few items will be sold at that price, offering the item for sale at that price for a very short period of time, and showing the price as reduced and the item discounted in comparative price advertisements is a deceptive and misleading practice pursuant to the CCPA. State ex rel. Woodard v. May Dept. Stores Co., 849 P.2d 802 (Colo. App. 1992).

Rescission and refunds under subsection (1)(t)(I) and (1)(t)(IV) were not available where buyer had previously cancelled contract, since at that point there was no contract to rescind and, after two years' use of club's facilities and services by buyer, parties could not be restored to their precontract status. Robinson v. Lynmar Racquet Club, Inc., 851 P.2d 274 (Colo. App. 1993).

Right of action based on failure to give notice of right to rescind under subsection (1)(t)(II) did not accrue until buyer learned of right to rescind by other means. Therefore, applicable limitation period did not begin to run and action was not time-barred. Robinson v. Lynmar Racquet Club, Inc., 851 P.2d 274 (Colo. App. 1993).

A breach of contract claim, without additional conduct, cannot constitute an actionable claim under this article. Unlike a breach of contract claim, which arises when one contracting party breaks a promise, a claim under this article arises when a party knowingly makes a misrepresentation or makes a false represen-

tation that has the capacity to deceive. A promise cannot constitute a misrepresentation unless the promisor did not intend to honor it at the time it was made. Rhino Linings USA, Inc. v. Rocky Mountain Rhino Lining, Inc., 62 P.3d 142 (Colo. 2003).

A forum selection clause is consistent with public policy under the Colorado Consumer Protection Act. Edge Telecom, Inc. v. Sterling Bank, 143 P.3d 1155 (Colo. App. 2006).

This article is inapplicable to excavating contracts. Herman v. Steamboat Springs Super 8 Motel, Inc., 634 P.2d 1005 (Colo. App. 1981).

Article inapplicable where the lease of a computer system was nothing other than a commercial transaction or where the alleged fraudulent misrepresentations had no effect on consumers generally. U.S. Welding, Inc. v. Burroughs Corp., 615 F. Supp. 554 (D. Colo. 1985).

Subsection (1)(z) does not provide notice of any requirement to obtain a license to sell collision damage waivers. Notice is only given that it is a violation of the act to fail to obtain "all governmental licenses or permits required". Consequently, because no statute or appellate decision has defined "insurance" to include collision damage waivers, and the Colorado supreme court has declared that the issue of whether a collision damage waiver is insurance has not been resolved, the trial court correctly held that plaintiff could not recover on his claim that defendants violated the licensing requirement. Mangone v. U-Haul Int'l, Inc., 7 P.3d 189 (Colo. App. 1999).

Although plaintiff cannot recover damages under his subsection (1)(z) claim, the trial court erred in excluding that portion of the purchase price relating to collision damage waivers from plaintiff's non-insurance claims pursuant to subsections (1)(e) and (1)(u). Mangone v. U-Haul Int'l, Inc., 7 P.3d 189 (Colo. App. 1999).

Subsection (1)(z) does not apply to real estate purchases. It applies to the performance of services and the sale of property. Shotkoski v. Denver Inv. Group Inc., 134 P.3d 513 (Colo. App. 2006).

Allegation of claim under this section need not be specifically pleaded. Heller v. Lexton-Ancira Real Estate Fund, 809 P.2d 1016 (Colo. App. 1990).

Certificate of review required by § 13-20-602 is not a prerequisite to a lawsuit against licensed real estate brokers based on paragraphs (1)(e) and (1)(g) where plaintiffs who had purchased a home alleged that licensed real estate brokers failed to disclose hidden damage to the home's foundation walls of which they had actual knowledge. Expert testimony would not be necessary to prove plaintiffs' claims of actual knowledge of the damage. However, plaintiffs' claim that brokers should have known about damage required a certificate of review and was properly dismissed because expert testimony would be necessary to establish the proper standard of care. Baumgarten v. Coppage, 15 P.3d 304 (Colo. App. 2000).

Subsection (3) does not allow recovery on two separate theories based on the same facts. Lexton-Ancira Real Estate Fund v. Heller, 826 P.2d 819 (Colo. 1992); Crowe v. Tull, 126 P.3d 196 (Colo. 2006).

Trial court did not err in refusing to direct a verdict for defendants where evidence revealed that, by representing to their customers that an easement existed across plaintiffs' property, defendants caused damage to the road and caused two prospective pasture leases to be lost, and where it was undisputed that the actions and representations of defendants caused fences to be torn down, locks to be cut, and gates to be left open. Walter v. Hall, 940 P.2d 991 (Colo. App. 1996), aff'd, 969 P.2d 224 (Colo. 1998).

Colorado state courts have jurisdiction over private actions under the Telephone Consumer Protection Act (TCPA), 47 U.S.C. § 227, under the supremacy clause of the United States Constitution, and the TCPA does not limit this jurisdiction, even assuming congress could do so. When congress created a private right of action that could be prosecuted in state courts, it was acknowledging that the states could apply their own rules of procedure to such an action, but it did not intend to require that any state adopt a further law or rule of court to allow the prosecution of such actions in its courts. The supremacy clause requires the exercise of such jurisdiction as the state court possesses. Consumer Crusade, Inc. v. Affordable Health Care Solutions, Inc., 121 P.3d 350 (Colo. App. 2005).

"If otherwise permitted" phrase under TCPA provisions creating a private right of action is merely an acknowledgment by congress that states have the right to structure their own court systems and that state courts are not obligated to change their procedural rules to accommodate TCPA claims. Under this view, no state can refuse to entertain a private TCPA action, but a state is not compelled to adopt a special procedural rule for such actions. Consumer Crusade, Inc. v. Affordable Health Care Solutions, Inc., 121 P.3d 350 (Colo. App. 2005).

The CCPA is not preempted by the federal Real Estate Settlement Procedures Act (RESPA) given the breadth of the CCPA and its regulation of far wider deceptive trade practices than those covered by RESPA. Perkins v. Johnson, 551 F. Supp. 2d 1246 (D. Colo. 2008).

Deceptive trade practice claims concerning the provisions of an apartment lease are subject to the lease's arbitration provision. Ingold v. AIMCO/Bluffs, L.L.C. Apartments, 159 P.3d 116 (Colo. 2007).

The public nature of the workers' compensation program is not sufficient to constitute per se public impact under the CCPA. Brodeur v. Am. Home Assurance Co., 169 P.3d 139 (Colo. 2007).

Company that made itself look better than it was by using language in its reports written and copyrighted by another company did not engage in a deceptive trade practice that significantly impacted the public. R.W. Beck, Inc. v. E3 Consulting, LLC, 577 F.3d 1133 (10th Cir. 2009).

Applied in Am. Television & Commc'ns Corp. v. Manning, 651 P.2d 440 (Colo. App. 1982); Nobody in Particular Presents, Inc. v. Clear Channel Commc'ns, Inc., 311 F. Supp. 2d (D. Colo. 2004); Campfield v. State Farm Mut. Auto. Ins. Co., 532 F.3d 1111 (10th Cir. 2008).

6-1-105.5. Hearing aid dealers - deceptive trade practices. (Repealed)

Source: L. 86: Entire section added, p. 443, § 1, effective April 17. **L. 87:** (2)(e)(III) amended, p. 358, § 5, effective July 1. **L. 88:** (2)(e)(II) amended, p. 343, § 3, effective July 1. **L. 92:** (1)(a), (1)(b), (2)(a), (2)(b), (2)(c), IP(2)(d), (2)(e), and (2)(f) amended and (1)(a.5), (1)(e), (2)(i), and (2)(j) added, pp. 228, 231, §§ 1, 2, effective July 1. **L. 93:** IP(2), (2)(e)(I), and (2)(i), amended, p. 1573, § 2, effective July 1. **L. 95.** IP(2) and (2)(e) amended and (3) added, p. 1331, § 2, effective July 1. **L. 99:** Entire section repealed, p. 655, § 14, effective May 18.

6-1-106. Exclusions. (1) This article does not apply to:

(a) Conduct in compliance with the orders or rules of, or a statute administered by, a federal, state, or local governmental agency;

(b) Publishers, including outdoor advertising media, advertising agencies, broadcasters, or printers engaged in the dissemination of information or reproduction of printed or pictorial matter who publish, broadcast, or reproduce material without knowledge of its deceptive character; or

(c) Actions or appeals pending on or before July 1, 1969.

(2) This article shall not be interpreted to apply to the use by a person of any service mark, trademark, certification mark, collective mark, trade name, or other trade identification which was used and not abandoned prior to July 1, 1969, if the use was in good faith and is otherwise lawful except for the provisions of this article.

Source: L. 69: p. 373, § 3. **C.R.S. 1963:** § 55-5-3.

ANNOTATION

This section does not exempt the insurance industry from the provisions of the Colorado Consumer Protection Act (CCPA). Showpiece Homes Corp. v. Assurance Co. of Am., 38 P.3d 47 (Colo. 2001).

This section does not exempt attorney conduct that constitutes deceptive or unfair trade practices from the provisions of the CCPA. Crowe v. Tull, 126 P.3d 196 (Colo. 2006).

The CCPA is not preempted by the federal Real Estate Settlement Procedures Act (RESPA) given the breadth of the CCPA and its regulation of far wider deceptive trade practices than those covered by RESPA. Perkins v. Johnson, 551 F. Supp. 2d 1246 (D. Colo. 2008).

Applied in People ex rel. MacFarlane v. Alpert Corp., 660 P.2d 1295 (Colo. App. 1982); Suarez v. United Van Lines, Inc., 791 F. Supp. 815 (D. Colo. 1992).

6-1-107. Powers of attorney general and district attorneys. (1) When the attorney general or a district attorney has cause to believe that any person has engaged in or is engaging in any deceptive trade practice listed in section 6-1-105 or part 7 of this article, the attorney general or district attorney may:

(a) Request such person to file a statement or report in writing under oath or otherwise, on forms prescribed by him, as to all facts and circumstances concerning the sale or

advertisement of property by such person and any other data and information he deems necessary;

(b) Examine under oath any person in connection with the sale or advertisement of any property;

(c) Examine any property or sample thereof, record, book, document, account, or paper he deems necessary;

(d) Make true copies, at the expense of the attorney general or district attorney, of any record, book, document, account, or paper examined pursuant to paragraph (c) of this subsection (1), which copies may be offered into evidence in lieu of the originals thereof in actions brought pursuant to sections 6-1-109 and 6-1-110; and

(e) Pursuant to any order of any district court, impound any sample of property which is material to such deceptive trade practice and retain the same in his possession until completion of all proceedings undertaken under this article. An order shall not be issued pursuant to this paragraph (e) without full opportunity given to the accused to be heard and unless the attorney general or district attorney has proven by clear and convincing evidence that the business activities of the person to whom an order is directed will not be impaired thereby.

(2) Nothing in subsection (1) of this section shall be construed to allow a district attorney to enforce the provisions of this article beyond the territorial limits of his judicial district, unless the alleged deceptive trade practice or any portion of a transaction involving an alleged deceptive trade practice occurred in said district attorney's judicial district, or unless the principal place of business of any defendant is located in said district attorney's district, or unless any defendant resides in said district attorney's judicial district.

Source: L. 69: p. 373, § 4. **C.R.S. 1963:** § 55-5-4. **L. 77:** IP(1), (1)(d), and (1)(e) amended and (2) added, p. 348, § 3, effective July 1. **L. 86:** IP(1) amended, p. 445, § 3, effective April 17. **L. 87:** (2) amended, p. 358, § 6, effective July 1. **L. 99:** IP(1) amended, p. 653, § 5, effective May 18.

6-1-108. Subpoenas - hearings - rules. (1) The attorney general or a district attorney, in addition to other powers conferred upon him by this article, may issue subpoenas to require the attendance of witnesses or the production of documents, administer oaths, conduct hearings in aid of any investigation or inquiry, and prescribe such forms and promulgate such rules as may be necessary to administer the provisions of this article.

(2) Service of any notice or subpoena may be made in the manner prescribed by law or the Colorado rules of civil procedure.

Source: L. 69: p. 374, § 5. **C.R.S. 1963:** § 55-5-5. **L. 77:** (1) amended, p. 349, § 4, effective July 1.

Cross references: For service of subpoena, see C.R.C.P. 45(c).

ANNOTATION

This section is not unconstitutionally defective in authorizing the attorney general to issue a subpoena. People ex rel. MacFarlane v. Am. Banco Corp., 194 Colo. 32, 570 P.2d 825 (1977).

The purpose of this section empowering the attorney general to make investigations and issue subpoenas is to enable him to determine whether an action for injunctive relief should be brought. People ex rel. MacFarlane v. Am. Banco Corp., 194 Colo. 32, 570 P.2d 825 (1977).

Refusal to submit to unreasonable subpoena. The person from whom information is sought may refuse to submit to the demands of the subpoena if it is unreasonable. People ex rel. MacFarlane v. Am. Banco Corp., 194 Colo. 32, 570 P.2d 825 (1977).

Issuance of administrative subpoena under this section by district attorney for dominant purpose of gathering evidence for a pending criminal prosecution is an abuse of process and evidence so obtained should be suppressed from use in the pending criminal prosecution. People v. Fleming, 804 P.2d 231 (Colo. App. 1990).

Absent a waiver of immunity, an Indian tribe is immune from any action — criminal, civil, or injunctive — the attorney general may

bring in a court to enforce the Colorado Consumer Protection Act. State ex rel. Suthers v. Cash Ad. & Pref., 205 P.3d 389 (Colo. App. 2008), aff'd on other grounds sub nom. Cash Advance & Pref. Cash Loans v. State, 242 P.3d 1099 (Colo. 2010).

Tribal sovereign immunity does not prevent the enforcement of the attorney general's subpoenas for information relevant to the determination by the trial court of whether sovereign immunity applies to a business affiliated with the tribe. State ex rel. Suthers v. Cash Ad. & Pref., 205 P.3d 389 (Colo. App. 2008), aff'd on other grounds sub nom. Cash Advance & Pref. Cash Loans v. State, 242 P.3d 1099 (Colo. 2010).

6-1-109. Remedies. (1) If any person fails to cooperate with any investigation pursuant to section 6-1-107 or fails to obey any subpoena pursuant to section 6-1-108, the attorney general or a district attorney may apply to the appropriate district court for an appropriate order to effect the purposes of this article. The application shall state that there are reasonable grounds to believe that the order applied for is necessary to terminate or prevent a deceptive trade practice as defined in this article. If the court is satisfied that reasonable grounds exist, the court in its order may:

(a) Grant injunctive relief restraining the sale or advertisement of any property by such person;

(b) Require the attendance of or the production of documents by such person, or both;

(c) Grant such other or further relief as may be necessary to obtain compliance by such person.

Source: L. 69: p. 374, § 6. **C.R.S. 1963:** § 55-5-6. **L. 77:** IP(1) amended, p. 349, § 5, effective July 1.

ANNOTATION

Law reviews. For article, "Trade Secret Litigation: Injunctions and Other Equitable Remedies", see 48 U. Colo. L. Rev. 189 (1977).

What subsection (1)(c) authorizes. Subsection (1)(c) authorizes the issuance of any appropriate order under the circumstances as opposed to permitting only an order to comply with the original subpoena. People ex rel. MacFarlane v. Am. Banco Corp., 194 Colo. 32, 570 P.2d 825 (1977).

The burden of seeking court review under article 1 of title 6 and of satisfying the court that reasonable grounds exist to believe the subpoena is necessary to terminate or prevent a deceptive trade practice is upon the attorney general (now attorney general or district attorney). People ex rel. MacFarlane v. Am. Banco Corp., 194 Colo. 32, 570 P.2d 825 (1977).

Hearsay evidence is admissible in proceedings to enforce subpoenas. People ex rel. MacFarlane v. Am. Banco Corp., 194 Colo. 32, 570 P.2d 825 (1977).

6-1-110. Restraining orders - injunctions - assurances of discontinuance. (1) Whenever the attorney general or a district attorney has cause to believe that a person has engaged in or is engaging in any deceptive trade practice listed in section 6-1-105 or part 7 of this article, the attorney general or district attorney may apply for and obtain, in an action in the appropriate district court of this state, a temporary restraining order or injunction, or both, pursuant to the Colorado rules of civil procedure, prohibiting such person from continuing such practices, or engaging therein, or doing any act in furtherance thereof. The court may make such orders or judgments as may be necessary to prevent the use or employment by such person of any such deceptive trade practice or which may be necessary to completely compensate or restore to the original position of any person injured by means of any such practice or to prevent any unjust enrichment by any person through the use or employment of any deceptive trade practice.

(2) Where the attorney general or a district attorney has authority to institute a civil action or other proceeding pursuant to the provisions of this article, the attorney general or district attorney may accept, in lieu thereof or as a part thereof, an assurance of discontinuance of any deceptive trade practice listed in section 6-1-105 or part 7 of this article. Such assurance may include a stipulation for the voluntary payment by the alleged violator of the costs of investigation and any action or proceeding by the attorney general or a district attorney and any amount necessary to restore to any person any money or property that may

have been acquired by such alleged violator by means of any such deceptive trade practice. Any such assurance of discontinuance accepted by the attorney general or a district attorney and any such stipulation filed with the court as a part of any such action or proceeding shall be a matter of public record unless the attorney general or the district attorney determines, at his or her discretion, that it will be confidential to the parties to the action or proceeding and to the court and its employees. Upon the filing of a civil action by the attorney general or a district attorney alleging that a confidential assurance of discontinuance or stipulation accepted pursuant to this subsection (2) has been violated, said assurance of discontinuance or stipulation shall thereupon be deemed a public record and open to inspection by any person. Proof by a preponderance of the evidence of a violation of any such assurance or stipulation shall constitute prima facie evidence of a deceptive trade practice for the purposes of any civil action or proceeding brought thereafter by the attorney general or a district attorney, whether a new action or a subsequent motion or petition in any pending action or proceeding.

(3) When the attorney general or a district attorney shows by a preponderance of evidence that a mortgage broker, mortgage originator, mortgage lender, mortgage loan applicant, real estate broker, real estate agent, real estate appraiser, or closing agent, other than a person who provides closing or settlement services subject to regulation by the division of insurance, has continued to participate in the origination of mortgage loans in violation of section 38-40-105, C.R.S., after having been previously enjoined from practices in violation of such section, the attorney general or district attorney may, in addition to any other remedies, apply for and obtain, in the court that has previously issued an injunction, a further injunction against continuing to participate in the business of originating mortgage loans for up to five years.

(4) In addition to any other remedy available under this section, when the attorney general or district attorney has cause to believe that a person has engaged in or is engaging in a deceptive trade practice described in section 6-1-720, the attorney general or district attorney may apply for and obtain, in an action in the appropriate district court of this state, an order forfeiting any tickets obtained, or the proceeds from the resale of any such tickets, in violation of section 6-1-720.

Source: L. 69: p. 374, § 7. **C.R.S. 1963:** § 55-5-7. **L. 77:** Entire section amended, p. 349, § 6, effective July 1. **L. 86:** Entire section amended, p. 446, § 4, effective April 17. **L. 87:** Entire section amended, p. 358, § 7, effective July 1. **L. 88:** (2) amended, p. 344, § 2, effective July 1. **L. 99:** Entire section amended, p. 653, § 6, effective May 18. **L. 2002:** (3) added, p. 1603, § 4, effective June 7. **L. 2007:** (3) amended, p. 1723, § 11, effective June 1. **L. 2008:** (4) added, p. 2230, § 2, effective July 1.

ANNOTATION

Law reviews. For article, "Trade Secret Litigation: Injunctions and Other Equitable Remedies", see 48 U. Colo. L. Rev. 189 (1977).

Where a violation occurs, this section permits the attorney general to apply for either a temporary restraining order or injunction or to seek a voluntary "assurance of discontinuance" from a party alleged to have engaged in deceptive trade practices. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

The attorney general should be granted the opportunity to choose, depending upon the circumstances of the case, between initiating an injunctive proceeding in court or accepting an assurance of discontinuance directly from the alleged violator. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

Where the attorney general has authority to institute a civil action, he may accept an assurance of discontinuance of the deceptive trade practice in lieu thereof, giving him the option, whenever he has cause to believe that a person has engaged in a deceptive trade practice, of either filing an action in court against the alleged violator or accepting his assurance that he will discontinue the illegal practice. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

When the attorney general seeks an injunction he is not demanding that the defendant be punished with a penal sanction, but rather that the defendant be restrained from acting unlawfully in the future, so it is unnecessary that this section provide absolutely precise warning before its equitable sanctions are applied. People

ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

Moreover, the failure to set forth criteria to assist the attorney general in choosing between the two methods of enforcement set out in this section is not a denial of equal protection in violation of the Colorado Constitution, for, while a legislative body may not delegate the power to make or define a law, it may delegate the power, authority, and discretion as to the execution and enforcement of the law. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

So long as the attorney general does not unreasonably abuse his discretion, his right to decide between accepting an assurance of discontinuance or initiating a court action will not be overturned on equal protection grounds. People ex rel. Dunbar v. Gym of Am., Inc., 177 Colo. 97, 493 P.2d 660 (1972).

Remedies not limited. Subsection (1) does not restrict the attorney general's choice of remedies to an election between injunctive relief and the assurances of discontinuance provided for in subsection (2). W. Food Plan, Inc. v. District Court, 198 Colo. 213, 598 P.2d 1038 (1979).

Attorney general may seek restitution separate from injunction for violations of this act. W. Food Plan, Inc. v. District Court, 198 Colo. 213, 598 P.2d 1038 (1979).

Section vests in trial court power to suppress proceedings brought under this act, and to keep the suppression in force until such time as the conditions set forth in the consent decree may be violated by the defendant. People ex rel. MacFarlane v. Delaware Corp., 626 P.2d 1144 (Colo. App. 1980).

Applied in People ex rel. MacFarlane v. Am. Banco Corp., 194 Colo. 32, 570 P.2d 825 (1977).

6-1-111. Information and evidence confidential and inadmissible - when. (1) Any testimony obtained by the attorney general or a district attorney pursuant to compulsory process under this article or any information derived directly or indirectly from such testimony shall not be admissible in evidence in any criminal prosecution against the person so compelled to testify. The provisions of this subsection (1) shall not be construed to prevent any law enforcement officer from independently producing or obtaining the same or similar facts, information, or evidence for use in any criminal prosecution.

(2) Subject to the provisions of section 6-1-110 (2), the records of investigations or intelligence information of the attorney general or a district attorney obtained under this article may be deemed public records available for inspection by the general public at the discretion of the attorney general or the district attorney. This subsection (2) shall not be construed to prevent the attorney general or a district attorney from issuing public statements describing or warning of any course of conduct or any conspiracy which constitutes a deceptive trade practice, whether on a local, statewide, regional, or nationwide basis.

Source: L. 69: p. 375, § 8. **C.R.S. 1963:** § 55-5-8. **L. 77:** Entire section amended, p. 350, § 7, effective July 1. **L. 81:** (1) amended, p. 401, § 1, effective April 30. **L. 88:** (2) amended, p. 344, § 5, effective July 1.

ANNOTATION

Grant of immunity contained in subsection (1) cannot withstand constitutional scrutiny. People ex rel. MacFarlane v. Sari, 196 Colo. 235, 585 P.2d 591 (1978) (decided prior to 1981 amendment).

Immunity allows state to compel testimony. A grant of immunity as extensive as a witness' constitutional privilege against self-incrimination allows a state to compel testimony which might otherwise be unobtainable. People ex rel. Smith v. Jordan, 689 P.2d 1172 (Colo. App. 1984).

6-1-112. Civil penalties. (1) The attorney general or a district attorney may bring a civil action on behalf of the state to seek the imposition of civil penalties as follows:

(a) Any person who violates or causes another to violate any provision of this article shall forfeit and pay to the general fund of this state a civil penalty of not more than two thousand dollars for each such violation. For purposes of this paragraph (a), a violation of any provision shall constitute a separate violation with respect to each consumer or

transaction involved; except that the maximum civil penalty shall not exceed five hundred thousand dollars for any related series of violations.

(b) Any person who violates or causes another to violate any court order or injunction issued pursuant to this article shall forfeit and pay to the general fund of this state a civil penalty of not more than ten thousand dollars for each such violation. For the purposes of this section, the court issuing the order or injunction shall retain jurisdiction, and the cause shall be continued. Upon violation, the attorney general or a district attorney may petition the court for the recovery of the civil penalty. Such civil penalty shall be in addition to any other penalty or remedy available for the enforcement of the provisions of this article and any court order or injunction.

(c) Any person who violates or causes another to violate any provision of this article, where such violation was committed against an elderly person, shall forfeit and pay to the general fund of the state a civil penalty of not more than ten thousand dollars for each such violation. For purposes of this paragraph (c), a violation of any provision of this article shall constitute a separate violation with respect to each elderly person involved.

(d) Any person who violates or causes another to violate the provisions of sections 6-1-105 (1) (e) and 6-1-723 by distributing, dispensing, or selling any product that is labeled as a "bath salt" or any other trademark if the product contains any amount of any cathinones, as defined in section 18-18-102 (3.5), C.R.S., shall forfeit and pay to the general fund of the state a civil penalty of not less than ten thousand dollars and not more than five hundred thousand dollars for each such violation; except that the person shall forfeit and pay to the general fund of the state a civil penalty of not less than twenty-five thousand dollars and not more than five hundred thousand dollars for each such violation if the person distributes, dispenses, or sells the product to a minor under the age of eighteen and the person is at least eighteen years of age and at least two years older than the minor.

Source: L. 69: p. 376, § 9. **C.R.S. 1963:** § 55-5-9. **L. 77:** Entire section amended, p. 351, § 8, effective July 1. **L. 87:** Entire section amended, p. 359, § 8, effective July 1. **L. 2000:** (3) added, p. 1107, § 2, effective August 2. **L. 2009:** Entire section amended, (SB 09-054), ch. 138, p. 596, § 1, effective August 5. **L. 2012:** (1)(d) added, (HB 12-1310), ch. 268, p. 1406, § 33, effective June 7.

ANNOTATION

The general assembly expressly stated its intent that penalties imposed under subsection (1) are civil in nature. Moreover, the fact that the legislature provided that civil enforcement proceedings are to be governed by the Colorado rules of civil procedure reinforces the legislature's intent to create a civil penalty. Duncan v. Norton, 974 F. Supp. 1328 (D. Colo. 1997).

Subsection (1) aids the Colorado Consumer Protection Act's overall remedial purpose of protecting the state's consumers against deceptive trade practices and is therefore properly characterized as serving primarily a remedial, and also a punitive, purpose. Duncan v. Norton, 974 F. Supp. 1328 (D. Colo. 1997).

Federal court declined to find that any amount of penalty imposed in the civil enforcement proceeding under subsection (1) would be so far criminal in nature as to preclude the attorney general from seeking penalties by use of plaintiff's prior compelled testimony. Duncan v. Norton, 974 F. Supp. 1328 (D. Colo. 1997).

Civil penalties based on the dissemination of misleading information rather than on the receipt of the information or on a consumer acting on the information effectuate the purpose of the statute. May Dept. Stores v. State, 863 P.2d 967 (Colo. 1993).

Statute is intended to punish wrongdoer not compensate injured party. May Dept. Stores v. State, 863 P.2d 967 (Colo. 1993).

"Each consumer or transaction" contemplates two separate violations, one involving a consumer and one involving a transaction. A consumer relying or acting upon an advertisement is a separate and distinct violation from the act of advertising. Consumer involvement almost necessarily involves injury while a transaction does not have to cause actual injury to the consumer to be a violation. May Dept. Stores v. State, 863 P.2d 967 (Colo. 1993).

This section does not require an actual injury or loss to a customer before a civil penalty may be awarded. State v. May Dept. Stores Co., 849 P.2d 802 (Colo. App. 1992).

In determining the amount of a civil penalty award, the court should apply the follow-

ing concepts: (a) The good or bad faith of the defendant; (b) the injury to the public; (c) the defendant's ability to pay; and (d) the desire to eliminate the benefits derived by violations of the Colorado Consumer Protection Act. State v. May Dept. Stores Co., 849 P.2d 802 (Colo. App. 1992).

Civil penalties awarded under subsection (1) are nondischargeable under 11 U.S.C. § 523(a)(7). The amounts awarded are penalties within the meaning of 11 U.S.C. § 523(a)(7). In re Jensen, 395 B.R. 472 (Bankr. D. Colo. 2008).

6-1-113. Damages. (1) The provisions of this article shall be available in a civil action for any claim against any person who has engaged in or caused another to engage in any deceptive trade practice listed in this article. An action under this section shall be available to any person who:

(a) Is an actual or potential consumer of the defendant's goods, services, or property and is injured as a result of such deceptive trade practice, or is a residential subscriber, as defined in section 6-1-903 (9), who receives unlawful telephone solicitation, as defined in section 6-1-903 (10); or

(b) Is any successor in interest to an actual consumer who purchased the defendant's goods, services, or property; or

(c) In the course of the person's business or occupation, is injured as a result of such deceptive trade practice.

(2) Except in a class action or a case brought for a violation of section 6-1-709, any person who, in a private civil action, is found to have engaged in or caused another to engage in any deceptive trade practice listed in this article shall be liable in an amount equal to the sum of:

(a) The greater of:

(I) The amount of actual damages sustained; or

(II) Five hundred dollars; or

(III) Three times the amount of actual damages sustained, if it is established by clear and convincing evidence that such person engaged in bad faith conduct; plus

(b) In the case of any successful action to enforce said liability, the costs of the action together with reasonable attorney fees as determined by the court.

(2.3) As used in subsection (2) of this section, "bad faith conduct" means fraudulent, willful, knowing, or intentional conduct that causes injury.

(2.5) Notwithstanding the provisions of subsection (2) of this section, in the case of any violation of section 6-1-709, in addition to interest, costs of the action, and reasonable attorney fees as determined by the court, the prevailing party shall be entitled only to damages in an amount sufficient to refund moneys actually paid for a manufactured home not delivered in accordance with the provisions of section 6-1-709.

(2.7) Notwithstanding the provisions of subsection (2) of this section, in the case of any violation of section 6-1-105 (1) (ss), the court may award reasonable costs of the action and attorney fees and interest, and in addition, the prevailing party shall be entitled only to damages in an amount sufficient to refund moneys actually paid for the installation of a manufactured home not installed in accordance with the provisions of part 33 of article 32 of title 24, C.R.S., that apply to the installation of manufactured homes.

(3) Any person who brings an action under this article that is found by the court to be groundless and in bad faith or for the purpose of harassment shall be liable to the defendant for the costs of the action together with reasonable attorney fees as determined by the court.

(4) Costs and attorney fees shall be awarded to the attorney general or a district attorney in all actions where the attorney general or the district attorney successfully enforces this article.

Source: L. 69: p. 376, § 12. **C.R.S. 1963:** § 55-5-12. **L. 86:** Entire section amended, p. 446, § 5, effective April 17. **L. 87:** Entire section amended, p. 360, § 9, effective July 1. **L. 98:** IP(2) amended and (2.5) added, p. 748, § 3, effective August 5. **L. 99:** Entire section amended, p. 636, § 1, effective May 18. **L. 2000:** (2.7) added, p. 1162, § 4, effective July 1, 2001. **L. 2001:** (1)(a) amended, p. 1461, § 3, effective August 8. **L. 2003:** (2.7) amended, p. 550, § 4, effective March 5.

ANNOTATION

Law reviews. For article, "Recreational Waivers in Colorado: Playing at Your Own Risk", see 32 Colo. Law. 77 (August 2003).

The treble damages provision of this section does not violate the due process or equal protection guarantees of the state and federal constitutions. Vista Resorts, Inc. v. Goodyear Tire & Rubber Co., 117 P.3d 60 (Colo. App. 2004).

For purposes of a private right of action, "any person" means a person who establishes that: (1) The defendant engaged in an unfair or deceptive trade practice; (2) the challenged practice occurred in the course of the defendant's business, vocation, or occupation; (3) it significantly impacts the public as actual or potential customers of the defendant's goods, services, or property; (4) the plaintiff suffered injury in fact to a legally protected interest; and (5) the challenged practice caused the plaintiff's injury. Hall v. Walter, 969 P.2d 224 (Colo. 1998); Loughridge v. Goodyear Tire & Rubber Co., 192 F. Supp.2d 1175 (D. Colo. 2002); Anson v. Trujillo, 56 P.3d 114 (Colo. App. 2002).

Factors applied in Full Draw Prods. v. Easton Sports, Inc., 85 F. Supp.2d 1001 (D. Colo. 2000).

The plain language of this section provides that any person may bring an action under the Colorado Consumer Protection Act (CCPA). Therefore, third-party non-consumers have standing to bring actions under the CCPA. Walter v. Hall, 940 P.2d 991 (Colo. App. 1996), aff'd, 969 P.2d 224 (Colo. 1998).

Plaintiff is not authorized to bring an action under the CCPA because, under the plain language of subsection (1), plaintiff was not an assignee whose assignors were actual consumers who purchased defendant's goods, services, or property, nor was plaintiff an actual or potential consumer of defendant's goods, services, or property injured as a result of the facsimile transmissions. By specifying in subsection (1) the circumstances under which a successor in interest may bring a CCPA claim, the general assembly necessarily excluded successors in interest from bringing claims under other circumstances. U.S. Fax Law Ctr. v. Myron Corp., 159 P.3d 745 (Colo. App. 2006).

Individual liability of corporate officers and agents proper under this article. This section allows civil actions against "any person" who has engaged in a deceptive trade practice. Hoang v. Arbess, 80 P.3d 863 (Colo. App. 2003).

Vicarious liability claim against mortgage brokerage firm that employed licensed securities broker who violated the CCPA survives motion to dismiss. Dolin v. Contemporary Fin. Solutions, Inc., 622 F. Supp. 2d 1077 (D. Colo. 2009).

Although the term "any person" is broad, the CCPA will not remedy private injuries. Loughridge v. Goodyear Tire & Rubber Co., 192 F. Supp.2d 1175 (D. Colo. 2002).

Three factors must be considered in assessing the public impact of an allegedly deceptive trade practice: The number of consumers directly affected by the challenged practice; the relative sophistication and bargaining power of the consumers affected by the challenged practice; and evidence that the challenged practice previously impacted other consumers or has significant potential to do so in the future. Loughridge v. Goodyear Tire & Rubber Co., 192 F. Supp.2d 1175 (D. Colo. 2002); Dean Witter Reynolds, Inc. v. Variable Annuity Life Ins. Co., 373 F.3d 1100 (10th Cir. 2004).

The CCPA requires actual injury before an individual may maintain a private cause of action. Hall v. Walter, 969 P.2d 224 (Colo. 1998); Purple Onion Foods, Inc. v. Blue Moose of Boulder, Inc., 45 F. Supp.2d 1255 (D. Colo. 1999).

Under Colorado law, a claim for liquidated damages under the Telephone Consumer Protection Act, 47 U.S.C. § 227, is a claim for a penalty that cannot be assigned. Kruse v. McKenna, 178 P.3d 1198 (Colo.), cert. denied, 555 U.S. 821, 129 S. Ct. 112, 172 L. Ed. 2d 35 (2008).

If a claim by a corporation is within the zone of interests of the CCPA, a corporation is a person entitled to bring a claim under the act. Fiberglass Component Prod. v. Reichhold Chems., Inc., 983 F. Supp. 948 (D. Colo. 1997).

Business losses that result when deceptive trade practices dissuade potential attendees from attending a trade show constitute an injury to an interest protected by the CCPA. Full Draw Prods. v. Easton Sports, Inc., 85 F. Supp.2d 1001 (D. Colo. 2000).

Challenged conduct must significantly impact the public as actual or potential consumers of the product. Martinez v. Lewis, 969 P.2d 213 (Colo. 1998); NetQuote, Inc. v. Byrd, 504 F. Supp. 2d 1126 (D. Colo. 2007).

Alleged misrepresentations concerning independent medical examiner's qualifications were made solely to sophisticated insurance company, not the public. Therefore, claim under CCPA brought by insured properly dismissed. Martinez v. Lewis, 969 P.2d 213 (Colo. 1998).

Allegations did not meet the public impact element required by this section because they did not plausibly suggest that defendant's conduct significantly impacted the public as actual or potential consumers. NetQuote, Inc. v. Byrd, 504 F. Supp. 2d 1126 (D. Colo. 2007).

The CCPA applies when the last event creating possible liability occurred in Colorado. Where allegedly disparaging statements were disseminated and individual allegedly suffered actual injury in Colorado, the CCPA applies. Purple Onion Foods, Inc. v. Blue Moose of Boulder, Inc., 45 F. Supp.2d 1255 (D. Colo. 1999).

Claimant not within group of persons the statute was intended to protect because the physician's conduct in performing claimant's independent medical examination occurred in the context of the contract between the physician and the insurer and not between the physician and the claimant. Claimant never asserted that the physician made false representations to her or that she relied on such misrepresentations. Martinez v. Lewis, 942 P.2d 1219 (Colo. App. 1996), aff'd, 969 P.2d 213 (Colo. 1998).

Award of attorney fees under this section appropriate inasmuch as defendant's fraudulent misrepresentation was a deceptive trade practice under § 6-1-103. Dodds v. Frontier Chevrolet Sales & Serv., Inc., 676 P.2d 1237 (Colo. App. 1983).

Attorney fees recoverable in action under No-Call List Act. A successful claimant under § 6-1-904 is entitled to attorney fees in accordance with this section. Holcomb v. Steven D. Smith, Inc., 170 P.3d 815 (Colo. App. 2007).

Trial court's award of attorney fees to defendant appropriate. To prove a private cause of action for a deceptive trade practice under the CCPA, a plaintiff must show that: (1) The defendant engaged in an unfair or deceptive trade practice; (2) the challenged practice occurred in the course of defendant's business; (3) it significantly impacted the public as actual or potential consumers of the defendant's goods, services, or property; (4) the plaintiff suffered injury in fact to a legally protected interest; and (5) the challenged practice caused the plaintiff's injury. Plaintiff's deceptive trade practices claim, therefore, was frivolous and groundless under subsection (3) when plaintiff failed to allege that defendant's conduct significantly impacted the public as an actual or potential consumer or submit factual material that would support such a finding. Wheeler v. T.L. Roofing, Inc., 74 P.3d 499 (Colo. App. 2003).

Award of attorney fees inappropriate under this section where plaintiff lacks standing to bring a cause of action pursuant to the CCPA. Anson v. Trujillo, 56 P.3d 114 (Colo. App. 2002).

Offer of settlement as to "all claims" unambiguously includes attorney fees and costs if the only claim for attorney fees and costs appears in the complaint. The offer of settlement need not explicitly reference attorney fees and costs. Bumbal v. Smith, 165 P.3d 844 (Colo. App. 2007).

Treble damages provided by this section and punitive damages awarded under § 13-21-102 serve the same purposes of punishment and deterrence. Lexton-Ancira Real Estate Fund v. Heller, 826 P.2d 819 (Colo. 1992).

Plaintiff was not entitled to recover both treble damages under this section and punitive damages under § 13-21-102, since damages under both sections serve same purposes. Lexton-Ancira Real Estate Fund v. Heller, 826 P.2d 819 (Colo. 1992).

If this section does not apply, punitive damages may still be available under other provisions of law. Section 13-21-102 allows for punitive damages, and even treble punitive damages, under some circumstances. Coors v. Sec. Life of Denver Ins. Co., 112 P.3d 59 (Colo. 2005).

Rule against double recovery does not preclude plaintiff from pursuing claims to recover both enhanced damages under this section and exemplary damages. Accordingly, plaintiffs' complaint should not have been dismissed on summary judgment. Although plaintiffs may not recover from defendant any actual damages for which they have already received payment and may not relitigate the amount of those damages, they must be permitted to attempt to establish their entitlement to treble damages under this section or exemplary damages under § 13-21-102. Quist v. Specialties Supply Co., Inc., 12 P.3d 863 (Colo. App. 2000).

Retroactive application of enhanced civil remedies in this section is permissible. Treble-damages provision of this section could be applied where health club had violated substantive provisions of act prior to amendment of this section, since amendment did not impose new duties on health clubs in relation to their customers. Robinson v. Lynmar Racquet Club, Inc., 851 P.2d 274 (Colo. App. 1993).

Attorney fees incurred in unsuccessful attempt to obtain class certification were properly disallowed, since subsection (2) clearly prohibits an award of attorney fees in a class action. Robinson v. Lynmar Racquet Club, Inc., 851 P.2d 274 (Colo. App. 1993).

Trial court may limit award of attorney fees to that which is "reasonable". Robinson v. Lynmar Racquet Club, Inc., 851 P.2d 274 (Colo. App. 1993).

A trial court is not required to advise a jury that a finding of deceptive trade practices will result in an award of treble damages under this section. Heritage Vill. Owners Ass'n v. Golden Heritage Investors, Ltd., 89 P.3d 513 (Colo. App. 2004).

This section not in conflict with § 13-17-201. This section allows attorney fees when claims are groundless and in bad faith or for the purpose of harassment, while § 13-17-201 applies to a motion pursuant to C.R.C.P. 12(b). The provisions can stand side by side because they

mandate awards in different circumstances. US Fax Law Ctr., Inc. v. Henry Schein, Inc., 205 P.3d 512 (Colo. App. 2009).

6-1-114. Criminal penalties. Upon a first conviction any person who promotes a pyramid promotional scheme in this state or who violates any provision of part 3 of article 5.5 of title 12, C.R.S., or section 6-1-717 is guilty of a class 1 misdemeanor, as defined in section 18-1.3-501, C.R.S., and, upon a second or subsequent conviction of part 3 of article 5.5 of title 12, C.R.S., is guilty of a class 6 felony, as defined in section 18-1.3-401, C.R.S.

Source: L. 73: p. 620, § 5. **C.R.S. 1963:** § 55-5-14. **L. 89:** Entire section amended, p. 820, § 2, effective July 1. **L. 92:** Entire section amended, p. 231, § 3, effective July 1. **L. 99:** Entire section amended, p. 654, § 7, effective May 18. **L. 2002:** Entire section amended, p. 1465, § 11, effective October 1. **L. 2007:** Entire section amended, p. 1728, § 6, effective June 1; entire section amended, p. 809, § 2, effective July 1. **L. 2008:** Entire section amended, p. 1879, § 6, effective August 5.

Editor's note: Amendments to this section by Senate Bill 07-208 and Senate Bill 07-085 were harmonized.

Cross references: For the legislative declaration contained in the 2002 act amending this section, see section 1 of chapter 318, Session Laws of Colorado 2002.

ANNOTATION

Law reviews. For article, "Criminal Prosecutions under the Colorado Securities Act", see 47 U. Colo. L. Rev. 233 (1976).

6-1-115. Limitations. All actions brought under this article must be commenced within three years after the date on which the false, misleading, or deceptive act or practice occurred or the date on which the last in a series of such acts or practices occurred or within three years after the consumer discovered or in the exercise of reasonable diligence should have discovered the occurrence of the false, misleading, or deceptive act or practice. The period of limitation provided in this section may be extended for a period of one year if the plaintiff proves that failure to timely commence the action was caused by the defendant engaging in conduct calculated to induce the plaintiff to refrain from or postpone the commencement of the action.

Source: L. 87: Entire section added, p. 360, § 10, effective July 1.

ANNOTATION

Applicable limitation statute is that in effect when claim accrues. Robinson v. Lynmar Racquet Club, Inc., 851 P.2d 274 (Colo. App. 1993).

PART 2

AUTO RENTAL CONTRACTS - COLLISION DAMAGE WAIVERS

6-1-201. Definitions. As used in this part 2, unless the context otherwise requires:

(1) "Collision damage waiver" means any contract or contractual provision, whether separate from or a part of a motor vehicle rental agreement, whereby the lessor agrees, for a charge, to waive any and all claims against the lessee for any damages to the rental motor vehicle during the term of the rental agreement.

(2) "Lessee" means any person or organization obtaining the use of a rental motor vehicle from a lessor under the terms of a rental agreement.

(3) "Lessor" means any person or organization in the business of providing rental motor vehicles to the public.

(4) "Private passenger type automobile or vehicle" means a motor vehicle of the private passenger or station wagon type, including passenger vans and minivans that are primarily for the transport of persons.

(5) "Rental agreement" means a written agreement setting forth the terms and conditions governing the use of a rental motor vehicle by a lessee for a period of less than one hundred eighty days.

(6) "Rental motor vehicle" means a private passenger type automobile or vehicle which, upon execution of a rental agreement, is made available to a lessee for its use.

Source: L. 89: Entire part added, p. 361, § 1, effective January 1, 1990.

6-1-202. Prohibited act. No lessor engaged in renting motor vehicles may sell to any lessee renting a motor vehicle in this state a collision damage waiver as part of the rental contract unless the lessor first gives the lessee written disclosure, as provided in section 6-1-203, of the terms and provisions of such waiver.

Source: L. 89: Entire part added, p. 361, § 1, effective January 1, 1990.

6-1-203. Collision damage waiver form - requirements - failure to comply. (1) Any collision damage waiver form shall conform to the following requirements:

(a) It shall be understandable and written in simple and readable plain language;

(b) The terms of such collision damage waiver, including, but not limited to, any conditions or exclusions applicable to the collision damage waiver, shall be prominently displayed;

(c) All restrictions, conditions, or provisions in, or endorsed on, the collision damage waiver shall be printed in type at least as large as brevier or ten-point type;

(d) The collision damage waiver shall include a statement of the total charge for the anticipated rental period or the anticipated total daily charge; and

(e) The agreement containing the collision damage waiver shall display the following notice on the face of the agreement, set apart and in bold-faced type, and in type at least as large as ten-point type:

> **NOTICE: THIS CONTRACT OFFERS, FOR AN ADDITIONAL CHARGE, A COLLISION DAMAGE WAIVER TO COVER YOUR RESPONSIBILITY FOR DAMAGE TO THE VEHICLE. YOU ARE ADVISED NOT TO SIGN THIS WAIVER IF YOU HAVE RENTAL VEHICLE COLLISION COVERAGE PROVIDED BY CERTAIN GOLD OR PLATINUM CREDIT CARDS OR COLLISION INSURANCE ON YOUR OWN VEHICLE. BEFORE DECIDING WHETHER TO PURCHASE THE COLLISION DAMAGE WAIVER, YOU MAY WISH TO DETERMINE WHETHER YOUR OWN VEHICLE INSURANCE AFFORDS YOU COVERAGE FOR DAMAGE TO THE RENTAL VEHICLE AND THE AMOUNT OF THE DEDUCTIBLE UNDER YOUR OWN INSURANCE COVERAGE. THE PURCHASE OF THIS COLLISION DAMAGE WAIVER IS NOT MANDATORY AND MAY BE WAIVED.**

(2) The failure by a lessor to comply with any provision of this section is a deceptive trade practice under the provisions of this article.

Source: L. 89: Entire part added, p. 362, § 1, effective January 1, 1990.

6-1-204. Prohibited exclusion. (1) No collision damage waiver subject to this part 2 shall contain an exclusion from the waiver for damages caused by the ordinary negligence of the lessee. Any such exclusion in violation of this section will be void and is a deceptive

trade practice under this article. This section shall not be deemed to prohibit an exclusion from the waiver for damages caused by the lessee by:

(a) Willful and wanton conduct or misconduct;

(b) Intoxication by alcohol or use of controlled substances as defined in section 42-4-1301, C.R.S.;

(c) Participation in a speed contest;

(d) Carrying persons or property for hire, or pushing or towing anything;

(e) Use of the vehicle while committing a misdemeanor or felony or other criminal act;

(f) Use of the vehicle by an unauthorized driver, which includes any person not specifically authorized by the rental agreement;

(g) Supplying information which is false concerning the rental transaction with intent to defraud the lessor;

(h) Use of the vehicle outside the continental United States, unless specifically authorized by the rental agreement; and

(i) Any instance whereby, during the rental of such rental motor vehicle, the speedometer or odometer is tampered with or disconnected.

Source: L. 89: Entire part added, p. 362, § 1, effective January 1, 1990. **L. 94:** (1)(b) amended, p. 2544, § 15, effective January 1, 1995.

6-1-205. Information to be disclosed in advertisements for rental agreements for rental motor vehicles. In any advertisement to the public for a rental agreement for a rental motor vehicle that includes a rental rate, the lessor shall prominently disclose on the face of any such advertisement the daily charge of any collision damage waiver offered, a statement informing a prospective lessee that he or she should review his or her own automobile insurance coverage to determine if such coverage applies to the use of a rental motor vehicle, and a statement that a prospective lessee may also wish to determine whether his or her credit card or travel and entertainment card provides collision damage coverage for use of a rental motor vehicle or other such privilege of membership.

Source: L. 89: Entire part added, p. 363, § 1, effective January 1, 1990. **L. 2006:** Entire section amended, p. 427, § 1, effective August 7.

PART 3

PREVENTION OF TELEMARKETING FRAUD

6-1-301. Legislative declaration. The general assembly hereby finds, determines, and declares that the use of telephones for commercial solicitation is rapidly increasing; that this form of communication offers unique benefits, but entails special risks and poses the potential for abuse; that the general assembly finds that the widespread practice of fraudulent and deceptive commercial telephone solicitation has caused substantial financial losses to thousands of consumers, and, particularly, elderly, homebound, and otherwise vulnerable consumers, and is a matter vitally affecting the public interest; and, therefore, that the general welfare of the public and the protection of the integrity of the telemarketing industry requires statutory regulation of the commercial use of telephones.

Source: L. 93: Entire part added, p. 944, § 3, effective July 1.

6-1-302. Definitions. As used in this part 3, unless the context otherwise requires:

(1) "Commercial telephone seller" or "seller" means a person who, in the course of such person's business, vocation, or occupation, on the person's own behalf or on behalf of another person, causes or attempts to cause a commercial telephone solicitation to be made; except that "commercial telephone seller" or "seller" does not include the following:

(a) A person offering or selling a security as defined in section 11-51-201 (17), C.R.S., if:

(I) The security is either registered with the securities commissioner under section 11-51-303 or 11-51-304, C.R.S., exempt from registration under section 11-51-307, C.R.S., or the transaction in the security is exempt under section 11-51-308, C.R.S.; and

(II) The person is licensed by the securities commissioner as a broker-dealer as defined in section 11-51-201 (2), C.R.S., unless expressly excluded from such definition, or as a sales representative as defined in section 11-51-201 (14), C.R.S., unless expressly excluded from such definition, or such person is exempted from licensing under section 11-51-402, C.R.S.;

(b) (I) A person soliciting the sale of any newspaper, magazine, or other periodical of general circulation if such sales constitute a majority of such person's business and business revenues; or

(II) A person soliciting the sale of any book, record, audio tape, compact disc, or video if the person allows the purchaser to review the merchandise without obligation for at least seven days and provides a full refund for the return of undamaged merchandise within thirty days or if the person solicits such sale on behalf of a membership club operating in conformity with 16 CFR 425;

(c) A person making telephone calls to a residential customer for the sole purpose of polling or soliciting the expression of ideas, opinions, or votes, or a person soliciting solely for a political or religious cause or purpose;

(d) A paid solicitor or charitable organization that is required to and has complied with the registration, notice, and filing requirements of sections 6-16-104.6 and 6-16-104, respectively, or a person who is excluded from such notice and reporting requirements by section 6-16-103 (7);

(e) A supervised financial organization, as defined in section 5-1-301 (45), C.R.S., and its employees, when acting within the scope of their employment;

(f) A supervised lender, as defined in section 5-1-301 (46), C.R.S., and its employees, when acting within the scope of their employment;

(g) A person selling insurance, as defined in section 10-1-102 (12), C.R.S., in compliance with the requirements of title 10, C.R.S.;

(h) A person soliciting without the intent to complete and who does not in fact complete the sales transaction during the telephone solicitation or another telephone solicitation and who only completes the sales transaction at a later face-to-face meeting between the solicitor and the prospective purchaser, excluding a face-to-face meeting, the sole purpose of which is to collect the payment or deliver any item purchased, or a person soliciting a purchaser with whom the person has had a previous face-to-face meeting in the course of such person's business;

(i) Any governmental entity or employee thereof, acting in the employee's official capacity;

(j) A person soliciting telephone service, or licensed or franchised cable television service, which is billed and paid on a daily, weekly, or monthly basis and which can be canceled at any time without further obligation to the purchaser;

(k) A person or an affiliate of a person whose business is regulated by the public utilities commission;

(l) A person or an affiliate of a person whose business is regulated by the real estate commission;

(m) A person whose conduct is within the exclusive jurisdiction of the federal commodity futures trading commission as granted under the federal "Commodity Exchange Act", as amended;

(n) A seller of food for immediate consumption when the sale to one purchaser does not exceed three hundred dollars;

(o) A person who initially contacts the purchaser with a retail sales catalog requesting a telephone call response, when the person allows the purchaser to review the merchandise without obligation for at least seven days and provides a full refund for the return of undamaged merchandise within thirty days after receipt of the returned merchandise;

(p) An issuer or a subsidiary of an issuer that has a class of securities which is subject to section 12 of the federal "Securities Exchange Act of 1934", 15 U.S.C. sec. 78l, and

which is either registered or exempt from registration under paragraph (A), (B), (C), (E), (F), (G), or (H) of subsection (g) (2) of that section;

(q) A person who has been operating for at least three years a retail business establishment in Colorado under the same name as that used in connection with the solicitation of sales by telephone if, on a continuing basis, the majority of the seller's business involves the purchaser receiving the seller's goods and services at the seller's business location;

(r) A person who has conducted business for at least three years under the same name and in the same state and offers potential purchasers satisfaction guaranteed by the sending of the product or providing the service and the purchaser has an unqualified right to review and return or cancel for at least thirty days;

(s) Any telephone marketing service company which provides telemarketing sales services under written contract to sellers and has been operating continuously for at least five years under the same business name and seventy-five percent or more of its services are performed on behalf of sellers exempt from this section. Nothing in this paragraph (s) shall be construed to exempt any seller that contracts with a telephone marketing service company for telemarketing sales services from the requirements set forth in section 6-1-303 or from the prohibitions set forth in section 6-1-304.

(t) A person soliciting business solely from business purchasers who have previously purchased identical or similar goods or services from the business enterprise on whose behalf the person is calling.

(2) "Commercial telephone solicitation" means:

(a) Unsolicited telephone calls to a person initiated by a commercial telephone seller or salesperson, or an automated dialing machine with or without a recorded message device, for the purpose of inducing the person to purchase or invest in goods, services, or property or offering an extension of credit; or

(b) Any other communication by a commercial telephone seller in which:

(I) A gift, award, or prize is offered and a telephone call response from the intended purchaser is invited; or

(II) A loan, credit card, or other extension of credit is offered to a purchaser who has not previously purchased from the person initiating the communication, and a telephone call response from the intended purchaser is invited; or

(III) A sale is to be completed or an agreement to purchase is to be entered into during the course of the telephone call response; or

(c) Any other communication by a commercial telephone seller which includes representations about the price, quality, or availability of goods, services, or property and which invites a response by telephone, including pay-per-call service calls, or which is followed by a telephone call to the intended purchaser by a salesperson.

(3) "Pay-per-call" means the use of a telephone number with a 900 prefix or any other prefix under which liability for the service or product provided attaches to the telephone bill of the individual calling such number.

(4) "Principal" means an owner, an officer of a corporation, a general partner of a partnership, the sole proprietor of a sole proprietorship, a trustee of a trust, or any other individual with similar supervisory functions with respect to any person.

(5) "Purchaser" means a person who receives or responds to a commercial telephone solicitation.

(6) "Salesperson" means any person employed or authorized by a commercial telephone seller to cause or attempt to cause a commercial telephone solicitation to be made.

(7) "Telephone sales transaction" means any payment of money by a purchaser in exchange for the promise of goods, services, property, or an extension of credit by a commercial telephone seller and includes all communications which precede such payment of money.

Source: L. 93: Entire part added, p. 944, § 3, effective July 1; (1)(b)(I) amended, p. 1573, § 3, effective July 1. **L. 97:** (1)(s) amended, p. 966, § 1, effective May 21. **L. 2000:** (1)(e) and (1)(f) amended, p. 1871, § 103, effective August 2. **L. 2001:** (1)(d) amended, p. 1250, § 9, effective May 9, 2002. **L. 2003:** (1)(g) amended, p. 613, § 2, effective July 1.

Cross references: For the federal "Commodity Exchange Act", see Pub.L. 74-675, codified at 7 U.S.C. § 1 et seq.

6-1-303. Registration of commercial telephone sellers. (1) No commercial telephone seller shall conduct business in this state without having registered with the attorney general at least ten days prior to the conduct of such business. Individual employees of the commercial telephone seller are not required to register. A commercial telephone seller conducts business in this state if the telephone solicitations of prospective purchasers are made from locations in this state or solicitation is made of prospective purchasers located in this state.

(2) A registration shall be effective for one year after the date of filing with the attorney general. Each application for registration or renewal thereof shall be accompanied by a filing fee, determined and collected by the attorney general, but such filing fee shall not exceed two hundred fifty dollars for an application for registration or one hundred dollars for an application for renewal.

(3) Whenever, prior to expiration of a commercial telephone seller's annual registration, there is a material change in the information required by subsection (5) of this section, the seller shall, within ten days, file an addendum updating the information with the attorney general.

(4) Each application for registration shall be in writing and shall contain such information regarding the conduct of the commercial telephone seller's business and the personnel conducting the business as is required by law. The application shall be submitted on a form provided by the attorney general and shall be verified by a declaration signed by each principal of the commercial telephone seller under penalty of perjury. The declaration shall specify the date and location of signing. The information submitted pursuant to this section shall be available for public inspection.

(5) Each application for registration or renewal pursuant to this section shall contain the following information:

(a) The name or names of the commercial telephone seller, including all names under which the commercial telephone seller is doing or intends to do business, if different from the name of the seller, and the name of any parent or affiliated organization;

(b) The seller's business form and the date and place of organization;

(c) The complete street addresses of all locations from which the commercial telephone seller is or will be conducting business, including a designation of the seller's principal business location;

(d) A listing of all telephone numbers, including pay-per-call numbers, to be used by the commercial telephone seller;

(e) The name, residential address, and position held by each principal of the commercial telephone seller and the names, residential addresses, and positions of those persons who have management responsibilities in connection with the commercial telephone seller's business activities;

(f) A description of the goods, services, property, or extension of credit the commercial telephone seller is offering for sale and a copy of all sales scripts the commercial telephone seller requires salespersons to use when soliciting prospective purchasers, or, if no sales script is required to be used, a description of the sales presentation;

(g) All rules, regulations, terms, restrictions, and conditions to receiving any prize, bonus, award, gift, or premium, if applicable, including a description of each prize, bonus, award, gift, or premium, and the actual or approximate odds of a purchaser's receiving such prize, bonus, award, gift, or premium;

(h) A copy or representative sample of all written materials the seller sends to any purchaser;

(i) Such additional information regarding the conduct of the commercial telephone seller's business and the personnel conducting the business as may reasonably be required by the attorney general.

Source: L. 93: Entire part added, p. 947, § 3, effective July 1.

6-1-304. Unlawful telemarketing practices. (1) A commercial telephone seller engages in an unlawful telemarketing practice when, in the course of any commercial telephone solicitation, the seller:

(a) Conducts business as a commercial telephone seller without having registered with the attorney general, as required by section 6-1-303;

(b) Fails to allow the purchaser in any telephone sales transaction to cancel any purchase or agreement to purchase goods, services, or property at any time before the expiration of three business days after the purchaser's receipt of such goods, services, or property by delivering or mailing to the commercial telephone seller written notice of cancellation. Notice of cancellation, if sent by mail, is deemed to be given as of the date the mailed notice was postmarked.

(c) Fails to refund all payments made by any purchaser in any telephone sales transaction within thirty days after the commercial telephone seller receives notice of cancellation from the purchaser; except that:

(I) If the purchaser has received goods or property from the commercial telephone seller, other than an item represented as free, the commercial telephone seller shall refund all payments made by the purchaser within thirty days after the commercial telephone seller's receipt of the returned goods or property;

(II) If the purchaser has received services, including those received during the course of a pay-per-call service call, which services cannot, by their nature, be returned, the commercial telephone seller is not required to refund payments to the purchaser;

(d) Fails to disclose to the purchaser during a telephone solicitation that the purchaser has the cancellation rights set forth in paragraph (b) of this subsection (1);

(e) Misrepresents to any person that the person has won a contest, sweepstakes, or drawing, or that the person will receive free goods, services, or property;

(f) Represents that the seller's goods, services, or property are "free" if the commercial telephone seller charges or collects a fee from the purchaser in exchange for providing or delivering such goods, services, or property;

(g) Makes any reference to the commercial telephone seller's compliance with this article to any purchaser without also disclosing that compliance with this article does not constitute approval by any governmental agency of the seller's marketing, advertisements, promotions, goods, or services;

(h) Engages in any deceptive trade practice defined in section 6-1-105 or part 7 of this article.

(2) Paragraphs (b) and (d) of subsection (1) of this section do not apply to a transaction in which the consumer obtains a full refund for the return of undamaged or unused goods or a cancellation of services by giving notice to the seller within seven days after receipt by the consumer and the seller processes the refund or cancellation within thirty days after receipt of the returned merchandise or the consumer's request for refund for services not performed or a pro rata refund for any services not yet performed for the consumer. The availability and terms of the return and refund privilege shall be disclosed to the consumer orally by telephone and in writing with any advertising or promotional material or with the delivery of the product or service. If a seller offers consumers an unconditional guarantee, a clear disclosure of such guarantee by using the words "satisfaction guaranteed", "free inspection", or "no-risk guarantee" satisfy the disclosure requirements of this subsection (2).

(3) The unlawful telemarketing practices listed in this section are in addition to and do not limit the types of unfair trade practices actionable at common law or under other civil and criminal statutes of this state.

(4) (a) On or after September 1, 2005, a person commits an unlawful telemarketing practice if the person knowingly:

(I) Lists a cellular telephone number in a directory for a commercial purpose unless the person whose number has been listed has given affirmative consent, through written, oral, or electronic means, to such listing; or

(II) Uses a scanning device or other electronic means to identify a cellular telephone number and to make a commercial telephone solicitation to a cellular telephone.

(b) This subsection (4) shall not apply to a commercial telephone solicitation that is in relation to a preexisting commercial relationship between the person and the person who owns the cellular telephone.

Source: L. 93: Entire part added, p. 949, § 3, effective July 1. **L. 99:** (1)(h) amended, p. 654, § 8, effective May 18. **L. 2000:** (1)(c)(II) amended, p. 244, § 2, effective March 30. **L. 2005:** (4) added, p. 630, § 1, effective August 8.

6-1-305. Penalties. (1) In addition to the remedies available under sections 6-1-110, 6-1-112, and 6-1-113:

(a) Any person who, after receiving written notice of noncompliance from the attorney general or a district attorney, conducts business as a commercial telephone seller without having registered with the attorney general as required by section 6-1-303 commits a class 1 misdemeanor and shall be punished as provided in section 18-1.3-501, C.R.S.;

(b) Any commercial telephone seller who knowingly engages in any unlawful telemarketing practice as defined in section 6-1-304 (1) (b) to (1) (h) commits a class 1 misdemeanor and shall be punished as provided in section 18-1.3-501, C.R.S.;

(c) A person who engages in any unlawful telemarketing practice as defined in section 6-1-304 (4) shall be liable in a private civil action to the owner of the cellular telephone for consequential damages, court costs, attorney fees, and a penalty in the amount of at least three hundred dollars and not more than five hundred dollars for a first offense and at least five hundred dollars and not more than one thousand dollars for a second or subsequent offense.

Source: L. 93: Entire part added, p. 950, § 3, effective July 1. **L. 2002:** (1)(a) and (1)(b) amended, p. 1465, § 12, effective October 1. **L. 2005:** (1)(c) added, p. 630, § 2, effective August 8.

Cross references: For the legislative declaration contained in the 2002 act amending subsections (1)(a) and (1)(b), see section 1 of chapter 318, Session Laws of Colorado 2002.

6-1-306. Repeal. (Repealed)

Source: L. 93: Entire part added, p. 951, § 3, effective July 1. **L. 96:** Entire section repealed, p. 788, § 2, effective July 1.

PART 4

WARRANTIES FOR ASSISTIVE TECHNOLOGY ACT

6-1-401. Legislative intent. (1) It is the intent of the general assembly to encourage and promote independent living and self-sufficiency for persons with disabilities and to reduce their need to rely on publicly funded supports. Of an estimated forty-nine million Americans with disabilities, approximately seventy percent of them are unemployed or underemployed. Having safe, reliable assistive technology represents a most essential need given the many barriers to independent living and self-sufficiency people with disabilities face.

(2) The goal of meeting this essential need can be furthered by assuring that assistive technology provided to persons with disabilities is of quality and is covered by adequate warranties to maintain their assistive technology in proper working condition, to assure availability of appropriate loaner replacement assistive technology while their own is being repaired, and to encourage manufacturers and dealers to cooperatively pool assistive technology resources for loaner purposes to assure availability without an undue burden.

(3) The general assembly finds and declares it is in the state's best interest to adopt this part 4.

Source: L. 97: Entire part added, p. 604, § 1, effective July 1.

6-1-402. Definitions. As used in this part 4, unless the context otherwise requires:

(1) "Collateral costs" means expenses incurred by a consumer in connection with the repair of a nonconformity in a wheelchair, including the cost of an alternative wheelchair, if a loaner, as that term is defined in subsection (8) of this section, was not offered to the consumer, or other assistive device or service for mobility assistance. "Collateral costs" shall not include the cost of hiring a personal assistant.

(2) "Consumer" means:

(a) A purchaser of a wheelchair, if the wheelchair was purchased from a wheelchair dealer or manufacturer for purposes other than resale;

(b) A person to whom a wheelchair is transferred for purposes other than resale, if such transfer occurs before the expiration of the express warranty applicable to such wheelchair;

(c) A person who may enforce the express warranty applicable to a wheelchair; or

(d) A person who leases a wheelchair from a wheelchair lessor under a written lease.

(3) "Dealer" means a person or entity that is in the business of selling wheelchairs or any agents of that person or entity. "Dealer" includes an alternative warranty service provider.

(4) (a) "Early termination cost" means any expense or obligation that a wheelchair lessor incurs as a result of:

(I) Terminating a written lease before the termination date set forth in the lease; and

(II) Returning the wheelchair to the manufacturer.

(b) "Early termination cost" includes any prepayment penalty under a finance arrangement.

(5) "Early termination savings" means any expense or obligation that a wheelchair lessor avoids as a result of performing the acts described in paragraph (a) of subsection (4) of this section. "Early termination savings" includes any interest charge that the wheelchair lessor would have paid to finance the wheelchair or, if the wheelchair lessor did not finance the wheelchair, the difference between the total amount the lessee was obligated to pay over the period of the lease term remaining after the early termination date and the present value of that amount on the early termination date.

(6) "Express warranty" means an express warranty as set forth in sections 4-2-313 and 4-2.5-210, C.R.S. An express warranty shall cover every part of a new wheelchair except the tires and batteries.

(7) "Lessor" means a person or entity that leases a wheelchair to a consumer or that holds the lessor's rights under a written lease or any agents of that person or entity.

(8) "Loaner" means a wheelchair that is provided to the consumer for use free of charge that is not required to have the functional capabilities equal to or greater than those of the original wheelchair but that meets the following conditions:

(a) It is in good working order;

(b) It performs at a minimum the most essential functions of the original wheelchair in light of the disabilities of the user;

(c) It is usable by the consumer given the consumer's impairments; and

(d) Any difference between the loaner and the original wheelchair does not create a threat to safety.

(9) "Manufacturer" means a person or entity that manufactures or assembles wheelchairs and any agents of that person or entity, including an importer, a distributor, an authorized servicer, a factory branch, a distributor branch, and warrantors of the manufacturer's wheelchairs. "Manufacturer" does not include a dealer.

(10) "Modular assembly" means a device added to the wheelchair base to accommodate the special needs of the consumer, such as seating systems, tilt or recline systems, and specially adapted control modules.

(11) "Nonconformity" means a defect that substantially impairs the use, reliability, value, or safety of a wheelchair and that is covered by an express warranty applicable to such wheelchair or a component of such wheelchair. "Nonconformity" does not include a defect that is the result of abuse, neglect, or the unauthorized modification or alteration of a wheelchair by a consumer.

(12) "Reasonable attempt to repair" means that one of the following has occurred within the term of an express warranty applicable to a new wheelchair or within one year after first delivery of a wheelchair to a consumer, whichever occurs earlier:

(a) The same nonconformity is subject to repair at least three times by the manufacturer, lessor, or any of the manufacturer's authorized dealers; or

(b) Because of a nonconformity, the wheelchair cannot be used by the consumer for an aggregate of at least thirty days or ten consecutive business days.

(13) "Replacement wheelchair" means a wheelchair of comparable quality, size, and function.

(14) "Selling dealer" means the entity that originally sold the wheelchair to the consumer and was involved in the design, assembly, fitting, and education of the consumer on the use and maintenance of the wheelchair.

(15) "Specialty control module" means the technologically advanced electronic device of limited availability that contains the signal and output circuitry for a power wheelchair designed and assembled for use by a specific individual with severe limitations who is unable to use a standard control module.

(16) "Standard wheelchair" means a wheelchair that has seat width and depth dimensions of sixteen to eighteen inches.

(17) "Wheelchair" means any wheelchair, scooter, or modular assembly, including a demonstrator, that is motor driven or manually operated that a consumer purchases or accepts transfer of in this state for the purposes of mobility assistance.

Source: L. 97: Entire part added, p. 605, § 1, effective July 1.

6-1-403. Express warranty required - authorized servicers. (1) (a) Except as provided in subsection (2) of this section, a consumer who purchases or leases a new wheelchair either directly or indirectly through a dealer or lessor shall receive an express warranty for such wheelchair. The manufacturer shall issue this express warranty that shall extend for not less than one year after first delivery to the consumer.

(b) Except as provided in subsection (2) of this section, a selling dealer shall provide an express warranty for any modifications made by the dealer that shall also extend for not less than six months after first delivery to the consumer.

(2) Notwithstanding the provisions of subsection (1) of this section, the warranty for the specialty control module shall be limited to the warranty provided by the manufacturer of such specialty control module or ninety days, whichever is longer.

(3) If a manufacturer or dealer fails to furnish the express warranty required by this section, the wheelchair shall be covered by a warranty the same as if an express warranty had been provided by the manufacturer or dealer pursuant to this section.

(4) Any entity that sells or leases wheelchairs in this state, including any entity that sells or leases through mail order or catalogue sales, shall designate an authorized servicer for such chairs that is located in this state in reasonable proximity to the consumer.

(5) (a) In the event that the selling dealer from whom the consumer purchased the wheelchair goes out of business or ceases to be an authorized dealer or service center for the manufacturer, or if the dealer or consumer moves or relocates to a location that makes it unreasonable for the consumer to seek warranty service from the selling dealer, or if the consumer is dissatisfied with the selling dealer, the consumer shall be responsible for contacting the manufacturer or another authorized dealer which will be responsible for facilitating the warranty service required with an authorized dealer, to be mutually agreed upon by the consumer and the manufacturer, which entity shall be referred to as the alternative warranty service provider.

(b) In the event that an alternative warranty service provider is designated pursuant to paragraph (a) of this subsection (5), the consumer may only seek warranty service from such alternative warranty service provider.

(c) To the extent reasonable and possible, the manufacturer shall take into account the independent mobility resources of the consumer when determining the alternative warranty service provider pursuant to the provisions of this subsection (5).

Source: L. 97: Entire part added, p. 607, § 1, effective July 1.

6-1-404. Remedies. (1) If a new wheelchair does not conform to the applicable express warranty and the consumer reports the nonconformity to the manufacturer, the lessor, the selling dealer, or the alternative warranty service provider, and makes the wheelchair available for repair within the warranty period, the nonconformity shall be repaired at no charge to the consumer. Any repairs performed pursuant to the provisions of this section shall be warranted for a period not less than the original warranty period. When the wheelchair is not safely moveable and there is no reasonable way for the consumer to deliver the wheelchair to the manufacturer or dealer, the manufacturer or dealer shall be responsible for the return of the wheelchair, or the wheelchair may be repaired on site at the option of the dealer.

(2) If the manufacturer authorizes the dealer or lessor to make the repair, the dealer or lessor shall make the repair and then be reimbursed by the manufacturer for the dealer's or lessor's cost for parts, labor, and repair if the nonconformity is a manufacturer's defect. A manufacturer shall respond to the dealer's or lessor's request for authorization to make a repair by the end of the business day that immediately follows the day such a request is made.

(3) When a wheelchair covered by an express warranty is tendered by a consumer to the manufacturer, selling dealer, alternative warranty service provider, or lessor for the repair of a defect, malfunction, or nonconformity to which the warranty is applicable, the consumer shall receive a loaner if the out-of-service period exceeds one day and shall keep the loaner until the requirements of section 6-1-405 or 6-1-406 are fulfilled. If the required loaner is not a standard wheelchair, the manufacturer or dealer shall make a good faith effort to make available alternative equipment that is usable by the consumer. The cost of the loaner shall be borne by the entity responsible for the defect requiring the repair or replacement of the wheelchair as provided in this section. The consumer shall have the duty to care for the loaner properly and to protect against any damage to the chair.

(4) If a nonconformity is not repaired after a reasonable attempt to repair, the manufacturer or dealer who originally supplied or modified the wheelchair, as required by this section, shall:

(a) If the wheelchair was purchased, take the following action at the direction of the consumer:

(I) Accept a return of the wheelchair, provide a replacement wheelchair of equal or greater value, and refund any collateral costs to the consumer, a holder of a perfected security interest in the wheelchair, or a third-party purchaser; or

(II) Accept a return of the wheelchair and refund to the consumer, holder of a perfected security interest in the wheelchair, or third-party purchaser not more than the full purchase price plus any finance charge, sales tax, shipping costs, and collateral costs paid;

(b) If the wheelchair was leased, take all of the following actions at the direction of the consumer:

(I) Accept a return of the wheelchair;

(II) (A) Refund to the lessor and any holder of a perfected security interest in the wheelchair the current value of the written lease.

(B) For purposes of this subparagraph (II), "current value of the written lease" means the sum of the total amount for which the consumer is obligated during the term of the lease remaining after the early termination date, the dealer's early termination costs, and the value of the wheelchair on the lease expiration date, if the lease sets forth that value, less the lessor's early termination savings.

(III) Refund to the consumer or third-party purchaser the amount paid under the lease plus any collateral costs.

(5) (a) In the event that a dispute arises as to liability under this part 4 between or among a manufacturer, dealer, lessor, or consumer, and the consumer is covered by any third-party insurer, such third-party insurer shall not be relieved of any obligation to provide benefits covered under its plan or applicable law.

(b) In the event that a wheelchair is found to be defective, the third-party payor described in paragraph (a) of this subsection (5) shall have all rights of recovery, including the right to costs, that the consumer would have had under this part 4.

Source: L. 97: Entire part added, p. 608, § 1, effective July 1.

6-1-405. Remedies for consumers - conditions. (1) To receive a refund or a replacement wheelchair, the consumer of a purchased wheelchair shall first offer to transfer the wheelchair with the nonconformity to the manufacturer, selling dealer, or alternative warranty service provider.

(2) Within thirty business days after receipt of the offer described in subsection (1) of this section, the manufacturer or dealer shall provide the consumer with a refund or a replacement wheelchair.

(3) When a manufacturer or dealer provides a consumer with a refund or a replacement wheelchair, such consumer shall return the wheelchair with the nonconformity, if such wheelchair is safely operable, to the manufacturer or dealer with any endorsements necessary to transfer possession to the manufacturer or dealer. When the wheelchair is not safely movable and there is no reasonable way for the consumer to deliver the wheelchair to the manufacturer or dealer, the manufacturer or dealer shall be responsible for the return of the wheelchair.

Source: L. 97: Entire part added, p. 610, § 1, effective July 1.

6-1-406. Remedies for consumers of leased wheelchairs - conditions. (1) To receive a refund due on a leased wheelchair, a consumer shall first offer to return the wheelchair with the nonconformity to the lessor.

(2) Within thirty business days after receipt of the offer described in subsection (1) of this section, the lessor shall provide the consumer with a refund.

(3) When a lessor provides a consumer with a refund, such consumer shall return the wheelchair with the nonconformity to such lessor.

(4) A lessor shall offer to transfer to a manufacturer or dealer the possession of a wheelchair returned pursuant to subsection (3) of this section. Within thirty business days after receiving such offer, the manufacturer or dealer shall remit the refund amount to the lessor. When the manufacturer or dealer makes such refund, the lessor shall provide the manufacturer or dealer with the endorsements necessary to transfer possession to the manufacturer or dealer.

Source: L. 97: Entire part added, p. 610, § 1, effective July 1.

6-1-407. Resale of a returned wheelchair - disclosure required. A wheelchair returned pursuant to this part 4 by a consumer in this state, or by a consumer in another state under a similar law of that state, shall not be sold or leased again in this state unless full disclosure is made to the prospective consumer of the reasons for the return.

Source: L. 97: Entire part added, p. 611, § 1, effective July 1.

6-1-408. Other remedies - waiver of rights void. (1) This part 4 shall not limit the rights or remedies available to a consumer under any other law of this state.

(2) If a consumer waives the rights granted to consumers pursuant to this part 4, such waiver shall be void as against public policy.

(3) Notwithstanding the remedies that are available to a consumer pursuant to this part 4, a consumer may pursue any other remedy, including an action to recover for damages caused by a violation of this part 4. If a manufacturer or dealer is found to have violated this part 4, a consumer shall be awarded the amount of actual damages caused by the violation and reasonable attorney fees. The consumer may be awarded collateral costs and punitive damages.

Source: L. 97: Entire part added, p. 611, § 1, effective July 1.

6-1-409. Fraudulent acts. Any manufacturer, dealer, or lessor that engages in conduct to delay making a final repair that is required as a consequence of the enforcement of warranties or duties under this part 4 with the intention of requiring payment of the cost of

such repair to be made by a publicly funded program of public assistance, medical assistance, or rehabilitation assistance commits the crime of theft, which crime shall be classified in accordance with section 18-4-401 (2), C.R.S., and which crime shall be punished as provided in section 18-1.3-401, C.R.S., if the crime is classified as a felony, or section 18-1.3-501, C.R.S., if the crime is classified as a misdemeanor.

Source: L. 97: Entire part added, p. 611, § 1, effective July 1. **L. 2002:** Entire section amended, p. 1465, § 13, effective October 1.

Cross references: For the legislative declaration contained in the 2002 act amending this section, see section 1 of chapter 318, Session Laws of Colorado 2002.

6-1-410. Arbitration. Disputes among manufacturers, dealers, and lessors concerning the enforcement of rights or remedies of consumers under this part 4 shall be subject to arbitration pursuant to the Colorado rules of civil procedure. The award of the arbitration panel shall be binding upon the parties and shall only be subject to court review by trial de novo.

Source: L. 97: Entire part added, p. 611, § 1, effective July 1.

6-1-411. Defect notification. (1) A manufacturer shall be responsible for providing written notification to an owner, user, purchaser, dealer, lessor, or consumer of any known or discovered inherent defect in a wheelchair that affects the safety, usability, or reliability of that wheelchair. The manufacturer shall send such notification by first class mail to the last known address of the owner, user, purchaser, dealer, lessor, or consumer within fourteen days after learning of such a defect.

(2) A manufacturer shall be responsible for the costs of providing the notification required in subsection (1) of this section and for all costs associated with correcting any defect described in subsection (1) of this section.

(3) The provisions of this section shall apply without time limitations.

Source: L. 97: Entire part added, p. 611, § 1, effective July 1.

6-1-412. Disclosures. (1) Prior to the sale of any wheelchair, the seller shall disclose whether the wheelchair is new or used and whether any warranty applies to such wheelchair.

(2) Upon delivery of a new or used wheelchair, the seller shall advise the buyer of any warranty rights under this part 4 and the wheelchair's maintenance schedule and operating instructions and shall provide the buyer with a copy of the owner's manual.

(3) The disclosure required pursuant to subsection (1) of this section and the advisement required pursuant to subsection (2) of this section shall be in writing and shall, in the case of buyer who is a person adjudicated not mentally competent, be provided to the guardian, parent, legal custodian, or primary caregiver of such person.

Source: L. 97: Entire part added, p. 612, § 1, effective July 1.

PART 5

WARRANTIES FOR FACILITATIVE TECHNOLOGY ACT

6-1-501. Definitions. As used in this part 5, unless the context otherwise requires:

(1) "Collateral costs" means expenses incurred by a consumer in connection with the repair of a nonconformity in a facilitative device, including the cost of an alternative facilitative device or other facilitative device or service.

(2) "Consumer" means:

(a) A purchaser of a facilitative device, if the facilitative device was purchased from a dealer or manufacturer for purposes other than resale;

(b) A person to whom a facilitative device is transferred for purposes other than resale, if such transfer occurs before the expiration of the express warranty applicable to such facilitative device;

(c) A person who may enforce the express warranty applicable to a facilitative device; or

(d) A person who leases a facilitative device from a lessor under a written lease.

(3) "Dealer" means a person or entity that is in the business of selling facilitative devices, or any agents of that person or entity. "Dealer" includes an alternative warranty service provider.

(4) (a) "Early termination cost" means any expense or obligation that a lessor of facilitative devices incurs as a result of:

(I) Terminating a written lease before the termination date set forth in the lease; and

(II) Returning the facilitative device to the manufacturer.

(b) "Early termination cost" includes any prepayment penalty under a finance arrangement.

(5) "Early termination savings" means any expense or obligation that a lessor of facilitative devices avoids as a result of performing the acts described in paragraph (a) of subsection (4) of this section. "Early termination savings" includes any interest charge that the lessor of facilitative devices would have paid to finance the facilitative device or, if the lessor did not finance the facilitative device, the difference between the total amount the lessee was obligated to pay over the period of the lease term remaining after the early termination date and the present value of that amount on the early termination date.

(6) "Express warranty" means an express warranty as set forth in sections 4-2-313 and 4-2.5-210, C.R.S. An express warranty shall cover every part of a new facilitative device.

(7) "Facilitative device" means a device that has a retail price equal to or greater than one hundred dollars and that is exclusively designed and manufactured to assist a person with a disability with such person's specific disability, through the use of facilitative technology, to be self-sufficient or to maintain or improve that person's quality of life. "Facilitative device" does not include wheelchairs as that term is defined in section 6-1-402 (17). "Facilitative device" does include the following:

(a) Telephone communication devices for the hearing impaired and other facilitative listening devices except for hearing aids as defined in section 12-5.5-301 (4), C.R.S., and cochlear implants as defined in section 12-5.5-301 (2), C.R.S.;

(b) Computer equipment and reading devices with voice input or output, optical scanners, talking software, braille printers, and other aids and devices that provide access to text by a person with a disability;

(c) Computer equipment with voice output, artificial larynges, voice amplification devices, and other alternative and augmentative communication devices;

(d) Voice recognition computer equipment, software and hardware accommodations, and other forms of alternative access to computers for persons with disabilities; and

(e) Any other device, other than a wheelchair, that enables a person with a disability to communicate, see, hear, or maneuver.

(8) "Facilitative technology" means technology used to develop technological devices to be used exclusively for the purpose of assisting a person with a disability with respect to such person's specific disability by facilitating or enhancing that person's ability to be self-sufficient.

(9) "Lessor" means a person or entity that leases a facilitative device to a consumer or that holds the lessor's rights under a written lease, or any agents of that person or entity.

(10) "Manufacturer" means a person or entity that manufactures or assembles facilitative devices and any agents of that person or entity, including an importer, a distributor, an authorized servicer, a factory branch, a distributor branch, and warrantors of the manufacturer's facilitative devices. "Manufacturer" does not include a dealer.

(11) "Nonconformity" means a defect that substantially impairs the use, reliability, value, or safety of a facilitative device and that is covered by an express warranty applicable to such facilitative device or a component of such facilitative device. "Nonconformity" does not include a defect that is the result of abuse, neglect, or the unauthorized modification or alteration of a facilitative device by a consumer.

(12) "Person with a disability" means a person who is considered to have a mental or physical disability, impairment, or handicap for purposes of any other law of this state or of the United States, including any rule or regulation.

(13) "Reasonable attempt to repair" means that one of the following has occurred within the term of an express warranty applicable to a new facilitative device or within one year after first delivery of a facilitative device to a consumer, whichever occurs earlier:

(a) The same nonconformity is subject to repair at least three times by the manufacturer, the lessor, or any of the manufacturer's authorized dealers; or

(b) Because of a nonconformity, the facilitative device cannot be used by the consumer for an aggregate of at least thirty days.

(14) "Replacement facilitative device" means a facilitative device of comparable quality, size, and function.

(15) "Selling dealer" means the entity that originally sold the facilitative device to the consumer and was involved in the design, assembly, fitting, and education of the consumer on the use and maintenance of the facilitative device.

Source: L. 98: Entire part added, p. 194, § 1, effective July 1. **L. 99:** (7)(a) amended, p. 654, § 9, effective May 18. **L. 2007:** (7)(a) amended, p. 809, § 3, effective July 1.

6-1-502. Express warranty required - authorized servicers. (1) A consumer who purchases or leases a new facilitative device either directly or indirectly through a dealer or lessor shall receive an express warranty for such facilitative device. The manufacturer shall issue this express warranty that shall extend for not less than one year after first delivery to the consumer.

(2) If a manufacturer or dealer fails to furnish the express warranty required by this section, the facilitative device shall be covered by a warranty the same as if an express warranty had been provided by the manufacturer or dealer pursuant to this section.

(3) Any entity that sells or leases facilitative devices in this state, including any entity that sells or leases through mail order or catalogue sales, shall designate an authorized servicer for such facilitative devices that is accessible to the consumer.

(4) (a) In the event that the selling dealer from whom the consumer purchased the facilitative device goes out of business or ceases to be an authorized dealer or service center for the manufacturer, or if the dealer or consumer moves or relocates to a location that makes it unreasonable for the consumer to seek warranty service from the selling dealer, or if the consumer is dissatisfied with the selling dealer, the consumer shall be responsible for contacting the manufacturer or another authorized dealer which will be responsible for facilitating the warranty service required with an authorized dealer, to be mutually agreed upon by the consumer and the manufacturer, which entity shall be referred to as the "alternative warranty service provider".

(b) In the event that an alternative warranty service provider is designated pursuant to paragraph (a) of this subsection (4), the consumer may only seek warranty service from such alternative warranty service provider.

Source: L. 98: Entire part added, p. 197, § 1, effective July 1.

6-1-503. Remedies. (1) If a new facilitative device does not conform to the applicable express warranty and the consumer reports the nonconformity to the manufacturer, the lessor, the selling dealer, or the alternative warranty service provider and makes the facilitative device available for repair within the warranty period, the nonconformity shall be repaired at no charge to the consumer. Any repairs performed pursuant to the provisions of this section shall be warranted for a period not less than the original warranty period.

(2) If the manufacturer authorizes the dealer or lessor to make the repair, the dealer or lessor shall make the repair and then be reimbursed by the manufacturer for the dealer's or lessor's cost for parts, labor, and repair if the nonconformity is a manufacturer's defect. A manufacturer shall respond to the dealer's or lessor's request for authorization to make a repair within three business days after such a request is made.

(3) If a nonconformity is not repaired after a reasonable attempt to repair, the manufacturer or dealer who originally supplied or modified the facilitative device, as required by this section, shall:

(a) If the facilitative device was purchased, take the following action at the direction of the consumer:

(I) Accept a return of the facilitative device, provide a replacement facilitative device of equal or greater value, and refund any collateral costs to the consumer, a holder of a perfected security interest in the facilitative device, or a third-party purchaser; or

(II) Accept a return of the facilitative device and refund to the consumer, holder of a perfected security interest in the facilitative device, or third-party purchaser not more than the full purchase price plus any finance charge, sales tax, shipping costs, and collateral costs paid;

(b) If the facilitative device was leased, take all of the following actions at the direction of the consumer:

(I) Accept a return of the facilitative device;

(II) (A) Refund to the lessor or any holder of a perfected security interest in the facilitative device the current value of the written lease.

(B) For purposes of this subparagraph (II), "current value of the written lease" means the sum of the total amount for which the consumer is obligated during the term of the lease remaining after the early termination date, the dealer's early termination costs, and the value of the facilitative device on the lease expiration date, if the lease sets forth that value, less the lessor's early termination savings.

(III) Refund to the consumer or third-party purchaser the amount paid under the lease plus any collateral costs.

(4) (a) In the event that a dispute arises as to liability under this part 5 between or among a manufacturer, dealer, lessor, or consumer and the consumer is covered by any third-party insurer, such third-party insurer shall not be relieved of any obligation to provide benefits covered under its plan or applicable law.

(b) In the event that a facilitative device is found to be defective, the third-party payor described in paragraph (a) of this subsection (4) shall have all rights of recovery, including the right to costs, that the consumer would have had under this part 5.

Source: L. 98: Entire part added, p. 198, § 1, effective July 1.

6-1-504. Remedies for consumers - conditions. (1) To receive a refund or a replacement facilitative device, the consumer of a purchased facilitative device shall first offer to transfer the facilitative device with the nonconformity to the manufacturer, selling dealer, or alternative warranty service provider.

(2) Within thirty business days after receipt of the offer described in subsection (1) of this section, the manufacturer or dealer shall provide the consumer with a refund or a replacement facilitative device.

(3) When a manufacturer or dealer provides a consumer with a refund or a replacement facilitative device, such consumer shall return the facilitative device with the nonconformity to the manufacturer or dealer with any endorsements necessary to transfer possession to the manufacturer or dealer.

Source: L. 98: Entire part added, p. 199, § 1, effective July 1.

6-1-505. Remedies for consumers of leased facilitative devices - conditions. (1) To receive a refund due on a leased facilitative device, a consumer shall first offer to return the facilitative device with the nonconformity to the lessor.

(2) Within thirty business days after receipt of the offer described in subsection (1) of this section, the lessor shall provide the consumer with a refund.

(3) When a lessor provides a consumer with a refund, such consumer shall return the facilitative device with the nonconformity to such lessor.

(4) A lessor shall offer to transfer to the manufacturer or dealer possession of the facilitative device returned pursuant to subsection (3) of this section. Within thirty business days after receiving such offer, the manufacturer or dealer shall remit the refund amount to the lessor. When the manufacturer or dealer makes such refund, the lessor shall provide the manufacturer or dealer with the endorsements necessary to transfer possession to the manufacturer or dealer.

Source: L. 98: Entire part added, p. 199, § 1, effective July 1.

6-1-506. Resale of a returned facilitative device - disclosure required. A facilitative device returned pursuant to this part 5 by a consumer in this state, or by a consumer in another state under a similar law of that state, shall not be sold or leased again in this state unless full disclosure is made to the prospective consumer of the reasons for the return.

Source: L. 98: Entire part added, p. 200, § 1, effective July 1.

6-1-507. Other remedies - waiver of rights void - limitation of coverage. (1) This part 5 shall not limit the rights or remedies available to a consumer under any other law of this state.

(2) This part 5 shall be in addition to and shall not limit the rights or remedies available to a consumer under any manufacturer's warranty with respect to a facilitative device or other technological device designed to be used by and assist a person with a disability, regardless of the retail price of the facilitative device or other technological device.

(3) If a consumer waives the rights granted to consumers pursuant to this part 5, such waiver shall be void as against public policy.

(4) Notwithstanding the remedies that are available to a consumer pursuant to this part 5, a consumer may pursue any other remedy, including an action to recover damages caused by a violation of this part 5. If a manufacturer or dealer is found to have violated this part 5, a consumer shall be awarded the amount of actual damages caused by the violation and reasonable attorney fees. The consumer may be awarded collateral costs and punitive damages.

(5) Nothing in this part 5 shall be deemed or construed to be a warranty to consumers of wheelchairs described in part 4 of this article.

Source: L. 98: Entire part added, p. 200, § 1, effective July 1.

6-1-508. Fraudulent acts. Any manufacturer, dealer, or lessor that engages in conduct to delay making a final repair that is required as a consequence of the enforcement of warranties or duties under this part 5 with the intention of requiring payment of the cost of such repair to be made by a publicly funded program of public assistance, medical assistance, or rehabilitation assistance commits the crime of theft, which crime shall be classified in accordance with section 18-4-401 (2), C.R.S., and which crime shall be punished as provided in section 18-1.3-401, C.R.S., if the crime is classified as a felony, or section 18-1.3-501, C.R.S., if the crime is classified as a misdemeanor.

Source: L. 98: Entire part added, p. 200, § 1, effective July 1. **L. 2002:** Entire section amended, p. 1465, § 14, effective October 1.

Cross references: For the legislative declaration contained in the 2002 act amending this section, see section 1 of chapter 318, Session Laws of Colorado 2002.

6-1-509. Arbitration. Disputes among manufacturers, dealers, and lessors concerning the enforcement of rights or remedies of consumers under this part 5 shall be subject to arbitration pursuant to the Colorado rules of civil procedure. The award of the arbitration panel shall be binding upon the parties and shall only be subject to court review by trial de novo.

Source: L. 98: Entire part added, p. 200, § 1, effective July 1.

6-1-510. Defect notification. (1) A manufacturer shall be responsible for providing written notification to an owner, user, purchaser, dealer, lessor, or consumer of any known or discovered inherent defect in a facilitative device that affects the safety, usability, or reliability of that facilitative device. The manufacturer shall send such notification by first-class mail to the last-known address of the owner, user, purchaser, dealer, lessor, or consumer within fourteen days after learning of such a defect.

(2) A manufacturer shall be responsible for the costs of providing the notification required in subsection (1) of this section and for all costs associated with correcting any defect described in subsection (1) of this section.

(3) The provisions of this section shall apply without time limitations.

Source: L. 98: Entire part added, p. 201, § 1, effective July 1.

6-1-511. Disclosures. (1) Prior to the sale of any facilitative device, the seller shall disclose whether the facilitative device is new or used and whether any warranty applies to such facilitative device.

(2) Upon delivery of a new or used facilitative device, the seller shall advise the consumer of any warranty rights under this part 5 and the facilitative device's maintenance schedule and operating instructions and shall provide the consumer with a copy of the owner's manual.

(3) The disclosure required pursuant to subsection (1) of this section and the advisement required pursuant to subsection (2) of this section shall be in writing and shall, in the case of a consumer who is a person adjudicated not mentally competent, be provided to the guardian, parent, legal custodian, or primary caregiver of such person.

Source: L. 98: Entire part added, p. 201, § 1, effective July 1.

PART 6

SELLERS OF MANUFACTURED HOMES - REGISTRATION, ESCROW AND BONDING, AND CONTRACT REQUIREMENTS

6-1-601 to 6-1-606. (Repealed)

Source: L. 2003: Entire part repealed, p. 532, § 1, effective March 5.

Editor's note: This part 6 was added in 1999 and was not amended prior to its repeal in 2003. For the text of this part 6 prior to 2003, consult the 2002 Colorado Revised Statutes.

PART 7

SPECIFIC PROVISIONS

Editor's note: This part 7 was added with relocations in 1999. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated.

6-1-701. Registered hearing aid providers - deceptive trade practices. (Repealed)

Source: L. 99: Entire part added with relocations, p. 637, § 2, effective May 18. **L. 2000:** (1)(d), (1)(f), IP(2), (2)(a)(I), (2)(a)(II), (2)(a)(III), (2)(c)(I), (2)(c)(II), (2)(e)(I), (2)(e)(II), (2)(e)(III), (2)(g), and (2)(j) amended and (1)(e.5) added, p. 1092, § 11, effective July 1; (1)(a) amended, p. 1837, § 1, effective August 2. **L. 2007:** Entire section repealed, p. 810, § 4, effective July 1.

Editor's note: This section was similar to former § 6-1-105.5, as it existed prior to 1999.

6-1-702. Unsolicited facsimiles - deceptive trade practice. (1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person:

(a) Uses a telephone facsimile machine, computer, or other device to send an unsolicited advertisement to a telephone facsimile machine;

(b) Uses a computer or other electronic device to send any message via a telephone facsimile machine unless such person clearly marks, in a margin at the top or bottom of each transmitted page of the message or on the first page of the transmission:

(I) The date and time the facsimile is sent;

(II) An identification of the person sending the facsimile; and

(III) The telephone number of the sending machine of the person; or

(c) Violates 47 U.S.C. sec. 227 or any rule promulgated thereunder.

(2) For the purposes of this section, unless the context otherwise requires:

(a) "Telephone facsimile machine" means equipment that has the capacity to:

(I) Transcribe text or images from paper into an electronic signal and to transmit that signal over a regular telephone line; or

(II) Transcribe text or images from an electronic signal received over a regular telephone line onto paper.

(b) "Unsolicited advertisement" means material that advertises the commercial availability or quality of any property, good, or service and that is transmitted to a person without that person's prior express invitation or permission.

(3) (a) The provisions of this section shall not apply to:

(I) A person who has an existing business relationship with the person receiving a facsimile; or

(II) A nonprofit organization operating pursuant to 26 U.S.C. sec. 501 (c) of the federal "Internal Revenue Code of 1986", as amended, that sends a facsimile to a nonmember recipient, if the nonprofit organization has received, by facsimile or other means, such nonmember recipient's prior express written invitation or permission to deliver facsimiles that includes the recipient's signature and facsimile number.

(b) For the purposes of this subsection (3), "existing business relationship" means a relationship formed by a voluntary two-way communication between a person or entity and a residential or business subscriber, with or without an exchange of consideration on the basis of an inquiry, application, purchase, membership, or transaction by the residential or business subscriber regarding products or services offered by such person or entity.

Source: L. 99: Entire part added with relocations, p. 641, § 2, effective May 18. **L. 2004:** Entire section R&RE, p. 406, § 1, effective August 4. **L. 2005:** (3) added, p. 463, § 1, effective May 4.

Editor's note: This section is similar to former § 6-1-105 (1)(p.3), (1)(p.5), and (1)(p.7), as it existed prior to 1999.

ANNOTATION

Law reviews. For article, "Regulating Faxing Activity Under State and Federal Law", see 34 Colo. Law. 63 (December 2005).

Colorado state courts have jurisdiction over private actions under the Telephone Consumer Protection Act (TCPA), 47 U.S.C. § 227, under the supremacy clause of the United States Constitution, and the TCPA does not limit this jurisdiction, even assuming congress could do so. When congress created a private right of action that could be prosecuted in state courts, it was acknowledging that the state could apply their own rules of procedure to such an action, but it did not intend to require that any state adopt a further law or rule of court to allow the prosecution of such actions in its courts. The supremacy clause requires the exercise of such jurisdiction as the state court possesses. Consumer Crusade, Inc. v. Affordable Health Care Solutions, Inc., 121 P.3d 350 (Colo. App. 2005).

"If otherwise permitted" phrase under TCPA provisions creating a private right of action is merely an acknowledgment by congress that states have the right to structure their own court systems and that state courts are not obligated to change their procedural rules to accommodate TCPA claims. Under

this view, no state can refuse to entertain a private TCPA action, but a state is not compelled to adopt a special procedural rule for such actions. Consumer Crusade, Inc. v. Affordable Health Care Solutions, Inc., 121 P.3d 350 (Colo. App. 2005).

Claims under the Colorado Consumer Protection Act (CCPA) are not assignable because the statute is penal in nature. U.S. Fax Law Ctr., Inc. v. iHire, Inc., 374 F. Supp.2d 924 (D. Colo. 2005); U.S. Fax Law Ctr., Inc. v. T2 Techs., Inc., 183 P.3d 626 (Colo. App. 2007), aff'd, 476 F.3d 1112 (10th Cir. 2007), cert. denied, 552 U.S. 1139, 128 S. Ct. 1062, 169 L. Ed. 2d 806 (2008).

A four-part test determines whether the CCPA is penal in nature and whether a CCPA claim is assignable. First, to be penal, a statute must create a new and distinct statutory cause of action. Second, the statute must require no proof of actual damages as a condition precedent to recovery. Third, the statute must impose a penalty in excess of actual damages. Finally, the statute must serve a public interest through a deterrent effect by the damages awarded. U.S. Fax Law Ctr., Inc. v. iHire, Inc., 374 F. Supp. 2d 924 (D. Colo. 2005); U.S. Fax Law Ctr., Inc. v. T2 Techs., Inc., 183 P.3d 626 (Colo. App. 2007), aff'd on other grounds, 476 F.3d 1112 (10th Cir. 2007), cert. denied, 552 U.S. 1139, 128 S. Ct. 1062, 169 L. Ed. 2d 806 (2008).

The same test applies to a claim under the TCPA. Kruse v. McKenna, 178 P.3d 1198 (Colo.), cert. denied, 555 U.S. 821, 129 S. Ct. 112, 172 L. Ed. 2d 35 (2008).

Under Colorado law, a claim for liquidated damages under the TCPA is a claim for a penalty that cannot be assigned. Kruse v. McKenna, 178 P.3d 1198 (Colo.), cert. denied, 555 U.S. 821, 129 S. Ct. 112, 172 L. Ed. 2d 35 (2008).

An action based on receipt by individuals of unsolicited faxes in violation of the TCPA is not assignable because such an action is in the nature of a violation of the right to privacy. McKenna v. Oliver, 159 P.3d 697 (Colo. App. 2006), cert. denied, 552 U.S. 1140, 128 S. Ct. 1062, 169 L. Ed. 2d 806 (2008).

Under the plain language of § 6-1-113 (1), the only assignees authorized to bring an action under the CCPA are those whose assignors were actual consumers who purchased defendant's goods, services, or property. U.S. Fax Law Ctr. v. Myron Corp., 159 P.3d 745 (Colo. App. 2006); U.S. Fax Law Ctr., Inc. v. T2 Techs., Inc., 183 P.3d 626 (Colo. App. 2007).

6-1-702.5. Commercial electronic mail messages - deceptive trade practice - remedies - definitions - short title - legislative declaration. (1) This section shall be known and may be cited as the "Spam Reduction Act of 2008".

(2) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person:

(a) Violates any provision of the federal "Controlling the Assault of Non-Solicited Pornography and Marketing ('CAN-SPAM') Act of 2003", 15 U.S.C. secs. 7701 to 7713, or any rule promulgated under the federal act that can be enforced by states or providers of internet access service pursuant to 15 U.S.C. sec. 7706 (f) or (g);

(b) Knowingly fails to disclose the actual point-of-origin electronic mail address of a commercial electronic mail message in order to mislead or deceive the recipient as to the source or sender of the message;

(c) Knowingly falsifies electronic mail transmission information or other routing information for a commercial electronic mail message in order to mislead or deceive the recipient as to the source or sender of the message;

(d) Knowingly uses a third party's internet address or domain name without the third party's consent for the purposes of transmitting a commercial electronic mail message; or

(e) Knowingly sends a commercial electronic mail message to any person that has previously given the sender a do-not-email directive under 15 U.S.C. sec. 7704 (a) (3) (A) or provides the electronic mail address of any such person to a third party for the purpose of enabling the third party to send a commercial electronic mail message, other than pursuant to affirmative consent, to that electronic mail address.

(3) As used in this section:

(a) "Affirmative consent" has the same meaning as set forth in 15 U.S.C. sec. 7702.

(b) "Commercial electronic mail message" has the same meaning as set forth in 15 U.S.C. sec. 7702.

(c) "Electronic mail service provider" means a provider of internet access service, as defined in 47 U.S.C. sec. 231.

(d) "Sender" has the same meaning as set forth in 15 U.S.C. sec. 7702.

(4) (a) In the case of any violation of this section, an electronic mail service provider whose network or facilities were used in the transmission or attempted transmission of a

commercial electronic mail message may file a civil action in a court of competent jurisdiction and may, upon proof of such violation, recover such sums as are allowed under this subsection (4).

(b) (I) In any such action, if the electronic mail service provider prevails, the provider shall be entitled to actual damages. Upon a showing that the sender of a commercial electronic mail message violated any provision of this section, whether or not the violation resulted in a financial loss or injury, the electronic mail service provider may recover attorney fees and costs.

(II) In any such action, if the electronic mail service provider prevails, the provider is also entitled to recover, as part of the judgment, statutory damages in the amount of one thousand dollars for each commercial electronic mail message transmitted in violation of this section; except that the total amount of statutory damages awarded against a single defendant based on one transaction or occurrence shall not exceed ten million dollars.

(c) The remedies, duties, prohibitions, and penalties of this subsection (4) are not exclusive and are in addition to all other causes of action, remedies, and penalties provided by law.

(d) At the request of any party to an action brought pursuant to this subsection (4), the court may, in its discretion, conduct all legal proceedings in such a way as to protect the secrecy and security of any computer, computer network, computer data, or computer software involved in order to prevent possible recurrence of the same or similar conduct by another person and to protect the trade secrets of any party.

(e) Electronic mail service providers that adopt and implement terms, conditions, or technical measures in good faith to prevent or prohibit the origination or transmission of commercial electronic mail messages in violation of this section shall be immune from civil liability for any such actions, and no provision of this section shall be construed to create any liability for such actions.

(f) No electronic mail service provider shall be liable for the mere transmission of commercial electronic mail messages over the provider's computer network or facilities.

(g) This section shall not be construed to require any electronic mail service provider to carry or deliver any electronic mail merely because a sender complies with the provisions of this section.

(h) This section shall apply when a commercial electronic mail message is sent to a computer located in Colorado or to an electronic mail address that the sender knows, or has reason to know, is held by a Colorado resident.

(5) (a) The attorney general is hereby specifically authorized to take all actions and invoke all remedies authorized under 15 U.S.C. sec. 7706 (f) to enforce this section. Such actions and remedies are not exclusive and are in addition to all other causes of action, remedies, and penalties provided by this article and any other state or federal law.

(b) The attorney general is encouraged to and may, in his or her discretion, cooperate with an electronic mail service provider in an action by such provider under 15 U.S.C. sec. 7706 (g).

(6) The general assembly:

(a) Finds that all violations of the federal "CAN-SPAM Act of 2003" are inherently false and deceptive;

(b) Determines that falsity and deception in any portion of a commercial electronic mail message or an attachment thereto harms Colorado consumers and threatens Colorado's economy; and

(c) Declares that the intent of this section and of section 18-5-308, C.R.S., is to exercise state authority in a manner consistent with, and to the maximum extent permissible under, the federal preemption provisions of 15 U.S.C. sec. 7707 (b).

Source: L. 2008: Entire section added, p. 593, § 1, effective August 5.

6-1-703. Time shares - deceptive trade practices. (1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person engages in one or more of the following activities in connection with the advertisement or sale of a time share:

(a) Misrepresents the investment, resale, or rental value of any time share; the conditions under which a purchaser may exchange the right to use accommodations or facilities in one location for the right to use accommodations or facilities in another location; or the period of time during which the accommodations or facilities contracted for will be available to the purchaser;

(b) Fails to allow any purchaser of a time share a right to rescind the sale within five calendar days after the sale;

(c) Fails to provide conspicuous notice on the contract of the right of a purchaser of a time share to rescind the sale either by telegram, mail, or hand delivery. For purposes of this section, notice of rescission is considered given, if by mail when postmarked, if by telegram when filed for telegraphic transmission, or if by hand delivery when delivered to the seller's place of business.

(d) Fails to refund any down payment or deposit made pursuant to a time share contract within seven days after the seller receives the purchaser's written notice of rescission.

Source: L. 99: Entire part added with relocations, p. 642, § 2, effective May 18.

Editor's note: This section is similar to former § 6-1-105 (1)(s), as it existed prior to 1999.

6-1-704. Health clubs - deceptive trade practices. (1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person engages in one or more of the following activities in connection with the advertisement or sale of a membership in a health club:

(a) Fails to allow any buyer of a membership in a health club to rescind the membership contract within three business days after receipt by the buyer of a copy of the contract;

(b) Fails to provide conspicuous notice of the right of a purchaser of a health club membership to rescind the sale either by telegram, mail, or hand delivery. For purposes of this section, notice of rescission is considered given, if by mail when postmarked, if by telegram when filed for telegraphic transmission, or if by hand delivery when delivered to the seller's place of business.

(c) Fails to allow the buyer, or the estate of the buyer, to cancel the membership contract when:

(I) The buyer dies;

(II) The buyer becomes totally physically disabled as determined by a licensed physician or advanced practice nurse for the duration of the membership contract;

(III) The health club is moved to a location that is more than five miles from the location of the establishment when the buyer entered into the membership contract;

(IV) The membership in the health club is transferred to a location of the same club or another club, which location is more than five miles from the location of the club when the buyer entered into the contract, and this transfer occurs because of cessation of health club services at the club location from which the membership is transferred;

(V) The seller permanently discontinues operation of the health club or sells the health club and the sale results in substantial alteration of the quality of health club services or facilities or the nature of benefits so that they no longer conform to the provisions of the membership contract, but there shall be a thirty-day "right to cure" during which the fees payable by the buyer under the membership contract shall be suspended and the health club may bring the services, facilities, and benefits into conformance with the provisions of the membership contract;

(d) Fails to refund all payments made pursuant to the membership contract, less a prorated fee for days of actual use of the health club by the buyer, within fifteen days after the seller receives the buyer's written notice of rescission;

(e) When a health club is planned or under construction, and the sale of the membership takes place before the health club is completed, fails to:

(I) Disclose clearly and conspicuously in the membership contract the date on which the health club will open for use;

(II) Escrow all preopening membership sales receipts in a separate account in a bank or trust company doing business in the state of Colorado or provide a cash bond, letter of

credit, certificate of deposit, or other similar surety, in the amount of fifty thousand dollars, for the repayment of amounts actually paid under preopening membership agreements until the health club is open for business;

(III) Allow the buyer to cancel the membership contract and receive a full refund of all payments made pursuant to the membership contract if the date the health club will open for use is delayed more than sixty days from the date of opening specified in the membership contract;

(f) Sells any membership contract, the actual or financial duration of which, including any option to renew, is longer than twenty-four months; except that a person does not engage in a deceptive trade practice when such person sells any membership contract the actual or financial duration of which is not longer than thirty-six months with a buyer's option to renew annually thereafter if:

(I) The health club has been in operation in this state more than two years; and

(II) The health club maintains a bond with a corporate surety from a company authorized to do business in this state or other security acceptable to and approved by the attorney general; and

(III) The aggregate amount of the bond is one hundred thousand dollars for each club location; and

(IV) The bond is payable to the state for the benefit of any buyer injured in the event the health club goes out of business prior to the expiration of the buyer's membership contract; and

(V) The bond is maintained for so long as the health club has any membership contracts in place and outstanding, the specified term for which exceeds twenty-four months; and

(VI) The bond is not cancelled, revoked, or terminated except after notice to, and with the written consent of, the attorney general at least forty-five days in advance of such cancellation, revocation, or termination; and

(VII) The annual renewal option for continued membership contained in the membership contract is not automatic but requires that the buyer affirmatively accept the renewal option by notice in writing to the person selling the membership contract for reasonable consideration on or before the expiration of each contract term, but not more than six months prior to the expiration of any contract term; and

(VIII) In the event that the health club elects to cancel, revoke, or terminate the bond, it posts a notice of such action, in twenty-four-point bold-faced type, to its customers, on the front door of such health club; or

(g) Makes any representation, orally or in writing, in connection with the offer or sale of a membership in a health club that a membership contract is for a lifetime or is for a perpetual membership, or uses coercive sales tactics, or misrepresents the quality, benefits, or nature of the services.

Source: L. 99: Entire part added with relocations, p. 643, § 2, effective May 18. **L. 2008:** (1)(c)(II) amended, p. 123, § 1, effective January 1, 2009.

Editor's note: This section is similar to former § 6-1-105 (1)(t), as it existed prior to 1999.

6-1-705. Dance studios - deceptive trade practices. (1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person engages in one or more of the following activities or practices in connection with the advertisement, sale, or performance of contracts for dance studio services in which the total amount of the obligation that the purchaser undertakes is in excess of five hundred dollars:

(a) Fails to execute a written contract and to provide a copy of the contract to the purchaser at the time the purchaser signs it;

(b) Fails to include, printed in ten-point, bold-faced type in the contract:

(I) The total amount of the obligation the purchaser undertakes;

(II) All goods and services that the purchaser is to receive under the contract set forth in specific terms, including the total number or hours of dance instruction to be given by the

dance studio under the contract broken down by different hourly rates, if applicable, and all other goods and services;

(III) The itemized cost of all goods and services to be provided under the contract, including but not limited to the cost per hour of dance instruction and the different hourly rates for different types of dance lessons, if any, and any charges to be paid by the purchaser for cost of travel, accommodations, or other expenses of dance studio owners, operators, managers, agents, or employees, the total cost of which shall equal the amount to be specified in the contract pursuant to subparagraph (I) of this paragraph (b); and

(IV) The purchaser's right to cancel as specified in paragraphs (c) to (e) of this subsection (1);

(c) Fails to include in the contract the following statement in bold-faced type under the conspicuous caption:

PURCHASER'S RIGHT TO CANCEL:

YOU, THE PURCHASER, MAY CANCEL THIS CONTRACT AT ANY TIME DURING THE TERM OF ITS EFFECTIVENESS. YOU MUST GIVE WRITTEN NOTICE TO THE DANCE STUDIO THAT YOU DO NOT WANT TO BE FURTHER BOUND BY THIS CONTRACT. THE NOTICE OF CANCELLATION MAY BE SERVED IN PERSON, BY TELEGRAM, OR BY MAIL TO THE DANCE STUDIO AT THE ADDRESS STATED IN THIS CONTRACT OR AT THE LOCATION WHERE DANCE LESSONS ARE CONDUCTED. WITHIN THIRTY DAYS AFTER RECEIPT OF YOUR NOTICE OF CANCELLATION, THE DANCE STUDIO SHALL REFUND TO YOU THE CONTRACT PRICE LESS THE COST OF GOODS AND SERVICES ALREADY RECEIVED BY YOU AND AN AMOUNT OF LIQUIDATED DAMAGES EQUAL TO NOT MORE THAN TEN PERCENT OF THE COST OF THE REMAINING GOODS AND SERVICES.

(d) Fails to allow the contract to be cancelled by the purchaser upon the purchaser's serving written notice to the dance studio;

(e) Fails, upon cancellation of a contract for dance studio services, to refund to the purchaser all prepayments made under the contract, minus the total of:

(I) The amount equal to the cost of goods and services actually received by the purchaser under the contract; and

(II) An amount of liquidated damages equal to not more than ten percent of the cost of the remaining goods and services not received by the purchaser;

(f) Subtracts a total amount under subparagraphs (I) and (II) of paragraph (e) of this subsection (1) that exceeds the total amount of the obligation as set out in subparagraph (I) of paragraph (b) of this subsection (1);

(g) Fails to have a performance bond in the amount of twenty-five thousand dollars, as to each studio, location, or owner, for the benefit of any person who enters into a contract for dance studio services in which the total amount of the obligation that the purchaser undertakes is in excess of five hundred dollars and who is damaged by the failure of the dance studio to provide the services specified in the contract or by the failure of the dance studio to comply with this section, which performance bond guarantees the dance studio's performance of its contractual obligations with the purchaser in accordance with the provisions of this section, or fails to disclose in the contract with such purchaser the existence of the performance bond;

(h) Sells or induces any person to purchase or to become obligated directly or contingently, or both, under more than one contract for dance studio services at the same time for the purpose of avoiding the provisions of this section; or

(i) Assigns or accepts an assignment of dance studio services without the written consent of the purchaser.

Source: L. 99: Entire part added with relocations, p. 645, § 2, effective May 18.

Editor's note: This section is similar to former § 6-1-105 (1)(w), as it existed prior to 1999.

6-1-706. Buyers' clubs - deceptive trade practices. (1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person engages in one or more of the following activities or practices in connection with the advertisement, sale, or performance of any contract of membership in a buyers' club in which the price of the membership equals or exceeds one hundred dollars:

(a) Fails to allow any purchaser of a membership in a buyers' club to rescind the membership contract at any time prior to the close of business on the next business day following the day the purchaser signs the contract;

(b) Fails to provide in the membership contract the following mandatory disclosure under the heading:

PURCHASER'S RIGHT TO CANCEL:

THE PURCHASER MAY CANCEL THIS CONTRACT FOR ANY REASON AT ANY TIME PRIOR TO THE CLOSE OF BUSINESS ON THE NEXT BUSINESS DAY FOLLOWING THE DAY THE PURCHASER SIGNS THE MEMBERSHIP CONTRACT BY DELIVERING OR MAILING TO THE BUYERS' CLUB WRITTEN NOTICE OF CANCELLATION. NOTICE OF CANCELLATION, IF SENT BY MAIL, IS DEEMED TO BE GIVEN AS OF THE DATE THE MAILED NOTICE WAS POSTMARKED.

Said heading and disclosure shall be in capital letters in no less than ten-point, bold-faced type.

(c) Fails to refund all payments made pursuant to the membership contract within fifteen days after the buyers' club receives notice of cancellation from the purchaser.

Source: L. 99: Entire part added with relocations, p. 646, § 2, effective May 18.

Editor's note: This section is similar to former § 6-1-105 (1)(bb), as it existed prior to 1999.

6-1-707. Use of title or degree - deceptive trade practice. (1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person:

(a) (I) Claims, either orally or in writing, to possess either an academic degree or an honorary degree or the title associated with said degree, unless the person has, in fact, been awarded said degree from an institution that is:

(A) Accredited by a regional or professional accrediting agency recognized by the United States department of education or the council on postsecondary accreditation, or is recognized as a candidate for accreditation by such an agency;

(B) Provided, operated, and supported by a state government or any of its political subdivisions or by the federal government;

(C) A school, institute, college, or university chartered outside the United States, the academic degree from which has been validated by an accrediting agency approved by the United States department of education as equivalent to the baccalaureate or postbaccalaureate degree conferred by a regionally accredited college or university in the United States;

(D) A religious seminary, institute, college, or university that offers only educational programs that prepare students for a religious vocation, career, occupation, profession, or lifework, and the nomenclature of whose certificates, diplomas, or degrees clearly identifies the religious character of the educational program;

(E) Authorized to grant degrees pursuant to article 2 of title 23, C.R.S.

(II) This paragraph (a) shall not apply to persons claiming degrees or certificates that were submitted as a requirement of the application process for licensure, certification, or registration pursuant to title 12, C.R.S.

(III) No person awarded a doctorate degree from an institution not listed in paragraph (a) of this subsection (1) shall claim in the state, either orally or in writing, the title "Dr." before the person's name or any mark, appellation, or series of letters, numbers, or words,

such as, but not limited to, "Ph.D.","Ed.D.", "D.N.", or "D.Th.", which signify, purport, or are generally taken to signify satisfactory completion of the requirements of a doctorate degree, after the person's name.

(b) Claims either orally or in writing to be a "dietitian", "dietician", "certified dietitian", or "certified dietician" or uses the abbreviation "C.D." or "D." to indicate that such person is a dietitian, unless such person:

(I) Possesses a baccalaureate, masters, or doctorate degree in human nutrition, foods and nutrition, dietetics, nutrition education, food systems management, or public health nutrition from an institution that is:

(A) Accredited by a regional or professional accrediting agency recognized by the United States department of education or the council on postsecondary accreditation, or is recognized as a candidate for accreditation by such accrediting agency;

(B) Authorized to grant degrees pursuant to article 2 of title 23, C.R.S.; or

(C) A school, institute, college, or university chartered outside the United States, the academic degree from which has been validated by an accrediting agency approved by the United States department of education as equivalent to a baccalaureate or postbaccalaureate degree conferred by a regionally accredited college or university in the United States; and

(II) Meets one of the following:

(A) Completes at least nine hundred hours of a planned, continuous, preprofessional work experience in a nutrition or dietetic practice under the supervision of a qualified dietitian; or

(B) Holds a certificate of registered dietitian through the commission on dietetic registration;

(c) Repealed.

(d) (I) Claims either orally or in writing to be a "certified optician" or "certified opticien", unless such person holds a current certificate of competence issued by the American board of opticianry. Each certificate shall be prominently displayed or maintained in such person's place of business and made available for immediate inspection and review by any consumer or agent of the state of Colorado. No person may associate a service, product, or business name with the title "certified optician" unless such person holds the required certificate of competence. This paragraph (d) shall not apply to persons authorized under article 36 or 40 of title 12, C.R.S., to practice medicine or optometry.

(II) Performs or claims orally or in writing to be able to perform the following procedures, and such person is a certified optician:

(A) Vision therapy;

(B) Refractions;

(C) Automated refractions; except that a certified optician may use an auto refractor to provide vision screenings for the sole purpose of determining if the subject of the screening needs a further eye examination;

(D) Refractometry;

(E) Fitting contact lenses;

(F) Keratometry or automated keratometry; or

(G) Any other act that constitutes the practice of optometry or the practice of medicine.

(III) A certified optician does not engage in a deceptive trade practice under subparagraph (II) of this paragraph (d), if said optician performs the described procedures under the direction and supervision of a person who has statutory authority under title 12, C.R.S., to supervise the work of others within the scope of his or her license.

(e) Claims to be a "sign language interpreter", "interpreter for the deaf", "deaf interpreter", "ASL-English interpreter", "American sign language (ASL) interpreter", "transliterator", "certified sign language interpreter", "certified interpreter for the deaf", "certified deaf interpreter", "certified ASL-English interpreter", "certified American sign language (ASL) interpreter", or "certified transliterator", unless he or she holds a current certification issued by the registry of interpreters for the deaf or a successor organization. A registry of interpreters for the deaf, or successor organization, membership card that shows proof of current membership and certification shall be made available for immediate inspection and review by any consumer or agent of the state of Colorado.

Source: L. 99: Entire part added with relocations, p. 647, § 2, effective May 18. **L. 2002:** (1)(c) amended, p. 97, § 1, effective August 7. **L. 2006:** IP(1)(b) amended, p. 1488, § 3, effective June 1. **L. 2008:** (1)(c) repealed, p. 829, § 2, effective July 1. **L. 2009:** (1)(e) added, (HB 09-1090), ch. 29, p. 121, § 1, effective September 1; (1)(e) amended, (SB 09-144), ch. 219, p. 993, § 12, effective August 5.

Editor's note: This section is similar to former § 6-1-105 (1)(dd), (1)(ee.5), (1)(ee.7), and (1)(ee.8), as it existed prior to 1999.

6-1-708. Motor vehicle sales and leases - deceptive trade practice. (1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person:

(a) Commits any of the following acts pertaining to the sale or lease of a motor vehicle or a used motor vehicle:

(I) Guarantees to a purchaser or lessee of a motor vehicle or used motor vehicle who conditions such purchase or lease on the approval of a consumer credit transaction as defined in section 5-1-301 (12), C.R.S., that such purchaser or lessee has been approved for a consumer credit transaction if such approval is not final. For purposes of this subparagraph (I), "guarantee" means a written document or oral representation between the purchaser or lessee and the person selling or leasing the vehicle that leads such purchaser or lessee to a reasonable good faith belief that the financing of such vehicle is certain.

(II) Accepts a used motor vehicle as a trade-in on the purchase or lease of a motor vehicle or used motor vehicle and sells or leases such used motor vehicle before the purchaser or lessee has been approved for a consumer credit transaction as defined in section 5-1-301 (12), C.R.S., if such approval is a condition of the purchase or lease;

(III) Fails to return to the purchaser or lessee any collateral or down payment tendered by such purchaser or lessee conditioned upon a guarantee by a motor vehicle dealer or used motor vehicle dealer that a consumer credit transaction as defined in section 5-1-301 (12), C.R.S., has been approved for such purchaser or lessee, if such approval was a condition of the sale or lease and if such financing is not approved and the purchaser or lessee is required to return the vehicle;

(b) Fails to disclose in writing, prior to sale, to the purchaser that a motor vehicle is a salvage vehicle, as defined in section 42-6-102 (17), C.R.S., or that a vehicle was repurchased by or returned to the manufacturer from a previous owner for inability to conform the motor vehicle to the manufacturer's warranty in accordance with article 10 of title 42, C.R.S., or with any other state or federal motor vehicle warranty law or knowingly fails to disclose in writing, prior to sale, to the purchaser that a motor vehicle has sustained material damage at any one time from any one incident.

(2) For purposes of this section, if a motor vehicle or used motor vehicle dealer guarantees financing and if approval for financing is a condition of the sale or lease, such motor vehicle or used motor vehicle dealer shall not retain any portion of such purchaser's down payment or any trade-in vehicle as payment of rent on any vehicle released by such dealer to such purchaser pending approval of financing even if such dealer has obtained a waiver of such purchaser's right to return a vehicle or has contracted for a rental agreement with such purchaser.

Source: L. 99: Entire part added with relocations, p. 650, § 2, effective May 18. **L. 2000:** (1)(a) and (2) amended, p. 244, § 3, effective March 30; (1)(a) amended, p. 1871, § 104, effective August 2. **L. 2001:** (1)(a) amended, p. 1265, § 2, effective June 5. **L. 2007:** (1)(b) amended, p. 2018, § 5, effective June 1.

Editor's note: (1) Subsection (1)(a) is similar to former § 6-1-105 (1)(ff)(I), subsection (1)(b) is similar to former § 6-1-105 (1)(ii), and subsection (2) is similar to former § 6-1-105 (1)(ff)(II), as they existed prior to 1999.

(2) Amendments to subsection (1)(a) by Senate Bill 00-080 and House Bill 00-1463 were harmonized.

6-1-709. Sales of manufactured homes - deceptive trade practices. A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person engages in conduct that constitutes an unlawful manufactured home sale practice as described in section 24-32-3326, C.R.S.

Source: L. 99: Entire part added with relocations, p. 651, § 2, effective May 18. **L. 2003:** Entire section amended, p. 550, § 5, effective March 5.

Editor's note: (1) This section is similar to former § 6-1-105 (1)(qq), as it existed prior to 1999.
(2) Section 6-1-105 (1)(qq) as amended by House Bill 99-1270 was harmonized with Senate Bill 99-143 and relocated to this section.

6-1-710. Installation or reinstallation of false air bag - deceptive trade practices - criminal liability. (1) A person engages in a deceptive trade practice when such person installs or reinstalls, as part of a vehicle inflatable restraint system, any object in lieu of an air bag that was designed in accordance with federal safety regulations for the make, model, and year of the vehicle.

(2) Any person who violates subsection (1) of this section is guilty of a misdemeanor and, upon conviction thereof, shall be punished by a fine of not less than two thousand five hundred dollars and not more than five thousand dollars per violation, or imprisonment in the county jail for up to one year, or both.

Source: L. 2002: Entire section added, p. 197, § 3, effective July 1.

6-1-711. Restrictions on credit card receipts - legislative declaration - application - definitions. (1) The general assembly hereby finds, determines, and declares that credit, particularly the use of credit cards, is an important tool for consumers in today's economy. Unscrupulous persons often fraudulently use the credit card accounts of others by stealing the credit card itself or obtaining the necessary information to fraudulently charge the purchase of goods and services to another person's credit card account. The general assembly, therefore, finds, determines, and declares that protection from unauthorized use of credit card accounts is necessary.

(2) No person that accepts credit cards for the transaction of business shall print more than the last five digits of the credit card account number or print the credit card expiration date, or both, on a credit card receipt.

(3) This section shall apply only to receipts that are electronically printed and shall not apply to transactions in which the sole means of recording the credit card number is by handwriting or by an imprint or copy of the credit card.

(4) For the purposes of this section, "credit card" means a card or device existing for the purpose of obtaining money, property, labor, or services on credit; those cards pursuant to which unpaid balances are payable upon demand; and any card or device used to withdraw moneys from a bank account.

(5) (a) Except as provided in paragraph (c) of this subsection (5), this section shall apply to any entity formed on and after April 25, 2002, that uses a cash register or any other machine or device that electronically imprints receipts on credit card transactions and is placed into service on or after April 25, 2002.

(b) Except as provided in paragraph (c) of this subsection (5), on and after January 1, 2004, this section shall apply to any cash register and any other machine or device that electronically imprints receipts on credit card transactions for entities that were formed on or before April 25, 2002.

(c) On and after January 1, 2005, this section shall apply to:

(I) Institutions of higher education; and

(II) Persons who employ no more than twenty-five employees or who have generated no more than five million dollars annually in revenues from the person's business activities.

Source: L. 2002: Entire section added, p. 379, § 1, effective April 25. **L. 2006:** (2) amended, p. 1324, § 10, effective July 1.

6-1-712. Discount health plan and cards - deceptive trade practices. (1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person:

(a) Solicits, markets, advertises, promotes, or sells to a consumer residing in Colorado a discount health plan and such plan materials:

(I) Fail to provide to the consumer a clear and conspicuous disclosure that the discount health plan is not insurance and that the plan only provides for discount health care services from participating providers within the plan;

(II) Fail to provide the name, address, and telephone number of the administrator of the discount health plan;

(III) Fail to make available to the consumer through a toll-free telephone number, upon request of the consumer, a complete and accurate list of the participating providers within the plan in the consumer's local area and a list of the services for which the discounts are applicable. Such list shall be available to the consumer upon request commencing with the time of purchase and shall be updated at least every six months.

(IV) Fail to use common usage for words and phrases in describing the discounts or access to discounts offered, and such failure results in representations of the discounts that are misleading, deceptive, or fraudulent;

(V) Fail to provide to the consumer notice of the right to cancel such discount health plan pursuant to paragraph (c) of this subsection (1);

(b) Offers discounted health services or products that are not authorized by a contract with each provider listed in conjunction with the discount health plan;

(c) Fails to allow a purchaser of a discount health plan to cancel such plan within thirty days after purchase;

(d) Fails to refund all membership fees paid to the discount health plan by the consumer within thirty days after timely notification of the cancellation of the plan to the discount health plan administrator pursuant to paragraph (c) of this subsection (1).

(2) The provisions of this section shall not apply to:

(a) A carrier as defined in section 10-16-102 (8), C.R.S., that offers discounts for services to a covered person, as defined in section 10-16-102 (13.5), C.R.S., and such services are supplemental to and not part of the health coverage plan of the carrier;

(b) A medicare endorsed drug card as approved by the centers for medicare and medicaid services pursuant to the "Medicare Prescription Drug, Improvement, and Modernization Act of 2003", Public Law 108-173.

(3) For the purposes of this section, unless the context otherwise requires:

(a) "Health care services" shall have the same meaning as in section 10-16-102 (22), C.R.S.

(b) "Provider" shall have the same meaning as in section 10-16-102 (36), C.R.S.

Source: L. 2004: Entire section added, p. 968, § 8, effective May 21.

6-1-713. Disposal of personal identifying documents - policy. (1) Each public and private entity in the state that uses documents during the course of business that contain personal identifying information shall develop a policy for the destruction or proper disposal of paper documents containing personal identifying information.

(2) For the purposes of this section, "personal identifying information" means: A social security number; a personal identification number; a password; a pass code; an official state or government-issued driver's license or identification card number; a government passport number; biometric data; an employer, student, or military identification number; or a financial transaction device.

(3) A public entity that is managing its records in compliance with part 1 of article 80 of title 24, C.R.S., shall be deemed to have met its obligations under subsection (1) of this section.

(4) Unless an entity specifically contracts with a recycler or disposal firm for destruction of documents that contain personal identifying information, nothing herein shall

require a recycler or disposal firm to verify that the documents contained in the products it receives for disposal or recycling have been properly destroyed or disposed of as required by this section.

Source: L. 2004: Entire section added, p. 1959, § 2, effective August 4.

Editor's note: This section was originally numbered as § 6-1-712 in House Bill 04-1311, but has been renumbered on revision for ease of location.

6-1-714. Unfair drug pricing practice - definitions - deceptive trade practice. (1) As used in this section, unless the context otherwise requires:

(a) "Emergency" means a declaration made by the department of public health and environment pursuant to section 25-1.5-101 (1) (aa), C.R.S., after the department has determined that there is a shortage of drugs critical to public safety.

(b) "Unfair drug pricing" means charging a consumer an unconscionable amount for the sale of a drug. Unfair drug pricing occurs if:

(I) The price charged by a wholesaler, distributor, or retailer exceeds by more than ten percent the average price for the drug charged by that wholesaler, distributor, or retailer during the thirty days immediately preceding the declaration of an emergency; and

(II) The increase in the amount charged by a wholesaler, distributor, or retailer is not attributable to cost factors of the retailer, including, but not limited to, replacement costs, taxes, and transportation costs incurred by that wholesaler, distributor, or retailer.

(2) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, the person engages in the practice of unfair drug pricing.

Source: L. 2005: Entire section added, p. 372, § 2, effective April 22.

6-1-715. Confidentiality of social security numbers. (1) Except as provided in subsections (2) to (4) of this section, a person or entity may not do any of the following:

(a) Publicly post or publicly display in any manner an individual's social security number. "Publicly post" or "publicly display" means to intentionally communicate or otherwise make available to the general public.

(b) Print an individual's social security number on any card required for the individual to access products or services provided by the person or entity;

(c) Require an individual to transmit his or her social security number over the internet, unless the connection is secure or the social security number is encrypted;

(d) Require an individual to use his or her social security number to access an internet web site, unless a password or unique personal identification number or other authentication device is also required to access the internet web site; and

(e) Print an individual's social security number on any materials that are mailed to the individual, unless state or federal law requires, permits, or authorizes the social security number to be on the document to be mailed. Notwithstanding this paragraph (e), social security numbers may be included in applications and forms sent by mail, including documents sent as part of an application or enrollment process, or to establish, amend, or terminate an account, contract, or policy, or to confirm the accuracy of the social security number. A social security number that is permitted to be mailed under this section may not be printed, in whole or in part, on a postcard or other mailer not requiring an envelope, or visible on the envelope or without the envelope having been opened.

(2) (a) A person or entity that has used, prior to January 1, 2007, an individual's social security number in a manner inconsistent with subsection (1) of this section, may continue using that individual's social security number in that manner on or after January 1, 2007, if all of the following conditions are met:

(I) The use of the social security number is continuous. If the use is stopped for any reason, subsection (1) of this section shall apply.

(II) The person or entity provides the individual with an annual disclosure that informs the individual that he or she has the right to stop the use of his or her social security number in a manner prohibited by subsection (1) of this section.

(b) The person or entity shall implement a written request by an individual to stop the use of his or her social security number in a manner prohibited by subsection (1) of this section within thirty days after the receipt of the request. The person or entity may not impose a fee or charge for implementing the request.

(c) The person or entity shall not deny services to an individual because the individual makes a written request pursuant to paragraph (b) of this subsection (2).

(3) This section shall not prevent the collection, use, or release of a social security number as required, permitted, or authorized by state or federal law or the use of a social security number for internal verification or administrative purposes, including by the department of revenue.

(4) This section shall not apply to:

(a) Documents or records that are recorded or required to be open to the public pursuant to the constitution or laws of this state or by court rule or order, and this section shall not limit access to these documents or records; or

(b) An entity that is subject to the federal "Health Insurance Portability and Accountability Act of 1996", as amended, 42 U.S.C. sec. 1320d to 1320d-9.

Source: L. 2006: Entire section added, p. 274, § 1, effective January 1, 2007. **L. 2010:** (4)(b) amended, (HB 10-1422), ch. 419, p. 2063, § 8, effective August 11.

6-1-716. Notification of security breach. (1) **Definitions.** As used in this section, unless the context otherwise requires:

(a) "Breach of the security of the system" means the unauthorized acquisition of unencrypted computerized data that compromises the security, confidentiality, or integrity of personal information maintained by an individual or a commercial entity. Good faith acquisition of personal information by an employee or agent of an individual or commercial entity for the purposes of the individual or commercial entity is not a breach of the security of the system if the personal information is not used for or is not subject to further unauthorized disclosure.

(b) "Commercial entity" means any private legal entity, whether for-profit or not-for-profit.

(c) "Notice" means:

(I) Written notice to the postal address listed in the records of the individual or commercial entity;

(II) Telephonic notice;

(III) Electronic notice, if a primary means of communication by the individual or commercial entity with a Colorado resident is by electronic means or the notice provided is consistent with the provisions regarding electronic records and signatures set forth in 15 U.S.C. sec. 7001 et seq.; or

(IV) Substitute notice, if the individual or the commercial entity required to provide notice demonstrates that the cost of providing notice will exceed two hundred fifty thousand dollars, the affected class of persons to be notified exceeds two hundred fifty thousand Colorado residents, or the individual or the commercial entity does not have sufficient contact information to provide notice. Substitute notice consists of all of the following:

(A) E-mail notice if the individual or the commercial entity has e-mail addresses for the members of the affected class of Colorado residents;

(B) Conspicuous posting of the notice on the web site page of the individual or the commercial entity if the individual or the commercial entity maintains one; and

(C) Notification to major statewide media.

(d) (I) "Personal information" means a Colorado resident's first name or first initial and last name in combination with any one or more of the following data elements that relate to the resident, when the data elements are not encrypted, redacted, or secured by any other method rendering the name or the element unreadable or unusable:

(A) Social security number;

(B) Driver's license number or identification card number;

(C) Account number or credit or debit card number, in combination with any required security code, access code, or password that would permit access to a resident's financial account.

(II) "Personal information" does not include publicly available information that is lawfully made available to the general public from federal, state, or local government records or widely distributed media.

(2) **Disclosure of breach.** (a) An individual or a commercial entity that conducts business in Colorado and that owns or licenses computerized data that includes personal information about a resident of Colorado shall, when it becomes aware of a breach of the security of the system, conduct in good faith a prompt investigation to determine the likelihood that personal information has been or will be misused. The individual or the commercial entity shall give notice as soon as possible to the affected Colorado resident unless the investigation determines that the misuse of information about a Colorado resident has not occurred and is not reasonably likely to occur. Notice shall be made in the most expedient time possible and without unreasonable delay, consistent with the legitimate needs of law enforcement and consistent with any measures necessary to determine the scope of the breach and to restore the reasonable integrity of the computerized data system.

(b) An individual or a commercial entity that maintains computerized data that includes personal information that the individual or the commercial entity does not own or license shall give notice to and cooperate with the owner or licensee of the information of any breach of the security of the system immediately following discovery of a breach, if misuse of personal information about a Colorado resident occurred or is likely to occur. Cooperation includes sharing with the owner or licensee information relevant to the breach; except that such cooperation shall not be deemed to require the disclosure of confidential business information or trade secrets.

(c) Notice required by this section may be delayed if a law enforcement agency determines that the notice will impede a criminal investigation and the law enforcement agency has notified the individual or commercial entity that conducts business in Colorado not to send notice required by this section. Notice required by this section shall be made in good faith, without unreasonable delay, and as soon as possible after the law enforcement agency determines that notification will no longer impede the investigation and has notified the individual or commercial entity that conducts business in Colorado that it is appropriate to send the notice required by this section.

(d) If an individual or commercial entity is required to notify more than one thousand Colorado residents of a breach of the security of the system pursuant to this section, the individual or commercial entity shall also notify, without unreasonable delay, all consumer reporting agencies that compile and maintain files on consumers on a nationwide basis, as defined by 15 U.S.C. sec. 1681a (p), of the anticipated date of the notification to the residents and the approximate number of residents who are to be notified. Nothing in this paragraph (d) shall be construed to require the individual or commercial entity to provide to the consumer reporting agency the names or other personal information of breach notice recipients. This paragraph (d) shall not apply to a person who is subject to Title V of the federal "Gramm-Leach-Bliley Act", 15 U.S.C. sec. 6801 et seq.

(3) **Procedures deemed in compliance with notice requirements.** (a) Under this section, an individual or a commercial entity that maintains its own notification procedures as part of an information security policy for the treatment of personal information and whose procedures are otherwise consistent with the timing requirements of this section shall be deemed to be in compliance with the notice requirements of this section if the individual or the commercial entity notifies affected Colorado customers in accordance with its policies in the event of a breach of security of the system.

(b) An individual or a commercial entity that is regulated by state or federal law and that maintains procedures for a breach of the security of the system pursuant to the laws, rules, regulations, guidances, or guidelines established by its primary or functional state or federal regulator is deemed to be in compliance with this section.

(4) **Violations.** The attorney general may bring an action in law or equity to address violations of this section and for other relief that may be appropriate to ensure compliance

with this section or to recover direct economic damages resulting from a violation, or both. The provisions of this section are not exclusive and do not relieve an individual or a commercial entity subject to this section from compliance with all other applicable provisions of law.

Source: L. 2006: Entire section added, p. 536, § 1, effective September 1. **L. 2010:** (2)(d) amended, (HB 10-1422), ch. 419, p. 2064, § 9, effective August 11.

6-1-717. Influencing a real estate appraisal. (1) A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, the person:

(a) Knowingly submits a false or misleading appraisal in connection with a dwelling offered as security for repayment of a mortgage loan; or

(b) Directly or indirectly compensates, coerces, or intimidates an appraiser, or attempts, directly or indirectly, to compensate, coerce, or intimidate an appraiser, for the purpose of influencing the independent judgment of the appraiser with respect to the value of a dwelling offered as security for repayment of a mortgage loan.

(2) The prohibition referred to in subsection (1) of this section shall not be construed as prohibiting a person from requesting an appraiser to:

(a) Consider additional, appropriate property information;

(b) Provide further detail, substantiation, or explanation for the appraiser's value conclusion; or

(c) Correct errors in the appraisal report.

Source: L. 2007: Entire section added, p. 1727, § 4, effective June 1.

6-1-718. Ticket sales and resales - prohibitions - unlawful conditions - definitions. (1) As used in this section, unless the context otherwise requires:

(a) "Operator" means a person or entity who owns, operates, or controls a place of entertainment or who promotes or produces entertainment and that sells a ticket to an event for original sale, including an employee of such person or entity.

(b) "Original sale" means the first sale of a ticket by an operator.

(c) "Place of entertainment" means a public or private entertainment facility, such as a stadium, arena, racetrack, museum, amusement park, or other place where performances, concerts, exhibits, athletic games, or contests are held, for which an entry fee is charged, to which the public is invited to observe, and for which tickets are sold. "Place of entertainment" does not include a ski area.

(d) "Purchaser" means a person or entity who purchases a ticket to a place of entertainment.

(e) "Resale" or "resold" means a sale other than the original sale of a ticket by a person or entity.

(f) "Reseller" means a person or entity that offers or sells tickets for resale after the original sale by the operator including an entity that operates a platform or exchange for the purchase and sale of tickets to events that also engages in the purchase and resale of the ticket either on behalf of the operator or on its own behalf if a reseller.

(g) "Ticket" means a license issued by the operator of a place of entertainment for admission to an event at the date and time specified on the ticket, subject to the terms and conditions as specified by the operator.

(2) Resellers shall guarantee a full refund to a purchaser if:

(a) The event for which the ticket was resold is canceled;

(b) The ticket does not or would not in fact grant the purchaser admission to the event for which the ticket was resold;

(c) The ticket is counterfeit; or

(d) The ticket fails to conform to its description as advertised or as represented to the purchaser by the reseller.

(3) (a) It is void as against public policy to apply a term or condition to the original sale to the purchaser to limit the terms or conditions of resale, including, but not limited to, a term or condition:

(I) That restricts resale in a subscription or season ticket package agreement as a condition of purchase;

(II) That a purchaser must comply with to retain a ticket for the duration of a subscription or season ticket package agreement that limits the rights of the purchaser to resell the ticket;

(III) That a purchaser must comply with to retain any contractually agreed-upon rights to purchase future subscriptions or season ticket package agreements; or

(IV) That imposes a sanction on the purchaser if the sale of the ticket is not through a reseller approved by the operator.

(b) Nothing in this section shall be deemed to prohibit an operator from prohibiting the resale of a contractual right in a season ticket package agreement that gives the original purchaser a priority or other preference to enter into a subsequent season ticket package agreement with the operator.

(4) A person or entity, including an operator, that regulates admission to an event shall not deny access to the event to a person in possession of a valid ticket to the event, regardless of whether the ticket is subject to a subscription or season ticket package agreement, based solely on the ground that such ticket was resold through a reseller that was not approved by the operator.

(5) Nothing in this section shall be construed to prohibit an operator from maintaining and enforcing policies regarding conduct or behavior at or in connection with the operator's venue. An operator may revoke or restrict season tickets for reasons relating to a violation of venue policies and to the extent the operator may deem necessary for the protection of the safety of patrons or to address fraud or misconduct.

Source: L. 2008: Entire section added, p. 108, § 1, effective March 19.

6-1-719. Truth in music advertising. (1) **Definitions.** As used in this section, unless the context otherwise requires:

(a) "Performing group" means a vocal or instrumental group seeking to use the name of a recording group.

(b) "Recording group" means a vocal or instrumental group, at least one of whose members has previously released a commercial sound recording under that group's name and in which at least one of the members has a legal right by virtue of use or operation under the group name without having abandoned the name or affiliation with the group.

(c) "Sound recording" means a work that results from the fixation, on or in a recording medium or other material object, of a series of musical, spoken, or other sounds regardless of the nature of the medium or object, such as a disk, tape, or other phono record, in which the sounds are recorded.

(2) **Production.** (a) Except as otherwise provided in paragraph (b) of this subsection (2), it is unlawful for any person to advertise or conduct a live musical performance or production in this state through the use of a false, deceptive, or misleading affiliation, connection, or association between a performing group and a recording group.

(b) Paragraph (a) of this subsection (2) does not apply if:

(I) The performing group is the authorized registrant and owner of a federal service mark for that group registered in the United States patent and trademark office;

(II) At least one member of the performing group was a member of the recording group and has a legal right by virtue of use or operation under the group name without having abandoned the name or affiliation with the group;

(III) The live musical performance or production is identified in all advertising and promotion as a salute or tribute;

(IV) The advertising does not relate to a live musical performance or production taking place in this state; or

(V) The performance or production is expressly authorized by the recording group.

(3) **Restraining prohibited acts.** In addition to the actions and remedies specified in part 1 of this article that may apply:

(a) **Injunction.** Whenever the attorney general or a district attorney has reason to believe that a person is advertising, conducting, or about to advertise or conduct a live musical performance or production in violation of this section and that proceedings would be in the public interest, the attorney general or district attorney may bring an action in the name of the state against the person to restrain that practice by temporary or permanent injunction.

(b) **Payment of costs and restitution.** Whenever a court issues a permanent injunction to restrain and prevent violations of this section as authorized in paragraph (a) of this subsection (3), the court may, in its discretion, direct that the defendant restore to any person in interest any moneys or property, real or personal, that may have been acquired by means of a violation of this section, under terms and conditions to be established by the court.

(c) **Penalty.** A person who violates this section is liable to the state for a civil penalty of not less than five thousand dollars nor more than fifteen thousand dollars per violation, which civil penalty shall be in addition to any other relief that may be granted under this subsection (3) but which shall not be cumulative with the penalty specified in section 6-1-112. Each performance or production that violates this section constitutes a separate violation.

Source: L. 2008: Entire section added, p. 364, § 1, effective August 5.

6-1-720. Deceptive trade practice - on-line event ticket sales. (1) A person engages in a deceptive trade practice when, in the course of the person's business, vocation, or occupation, such person:

(a) Uses or causes to be used a software application that runs automated tasks over the internet to access a computer, computer network, or computer system, or any part thereof, for the purpose of purchasing tickets in excess of authorized limits for an on-line event ticket sale with the intent to resell such tickets; or

(b) Uses or causes to be used a software application that runs automated tasks over the internet that circumvents or disables any electronic queues, waiting periods, or other sales volume limitation systems associated with an on-line event ticket sale.

(2) As used in this section, unless the context otherwise requires:

(a) "In excess of authorized limits", with regard to an on-line purchase of tickets, means exceeding a restriction on the number of individual tickets that can be purchased by any single person or circumventing any other terms and conditions of access to an on-line event ticket sale established by the event sponsor or promoter.

(b) "On-line event ticket sale" means an electronic system utilized by the sponsor or promoter of a sporting or entertainment event to sell tickets to such event to the public over the internet.

(3) This section shall not prohibit the resale of tickets in a secondary market by a person other than the event sponsor or promoter.

(4) Every ticket acquired in violation of this section shall constitute a separate violation for purposes of assessing a civil penalty under section 6-1-112 (1) (a) and (1) (b).

Source: L. 2008: Entire section added, p. 2229, § 1, effective July 1. **L. 2009:** (4) amended, (SB 09-054), ch.138, p. 597, § 3, effective August 5.

6-1-721. Like-kind exchanges by exchange facilitators - definitions. (1) **Legislative declaration.** The general assembly hereby:

(a) Finds that, absent enactment of this section, Colorado has no requirements for the protection of taxpayers who engage persons or entities that facilitate like-kind exchanges pursuant to 26 U.S.C. sec. 1031; and

(b) Determines that, to protect taxpayers who engage exchange facilitators, exchange facilitators should meet certain requirements and follow certain procedures.

(2) **Definitions.** As used in this section, unless the context otherwise requires:

(a) "Affiliated with" means that a person directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the other specified person.

(b) "Colorado property" means real property located in Colorado; except that replacement property need not be located in Colorado.

(c) (I) "Exchange facilitator" means a person that holds a taxpayer's exchange funds and that:

(A) For a fee, facilitates an exchange of like-kind Colorado property by entering into an agreement with a taxpayer by which the exchange facilitator acquires from the taxpayer the contractual rights to sell the taxpayer's relinquished Colorado property and transfer a replacement property to the taxpayer as an exchange facilitator, as is defined in 26 CFR 1.1031 (k)-1 (g) (4), or enters into an agreement with a taxpayer to take title to Colorado property as an exchange accommodation titleholder, as that term is defined in federal internal revenue service revenue procedure 2000-37, or enters into an agreement with a taxpayer to act as a qualified trustee or qualified escrow holder, as those terms are defined in 26 CFR 1.1031 (k)-1 (g) (3), except as otherwise provided in subparagraph (II) of this paragraph (c); or

(B) Maintains an office in this state for the purpose of soliciting business as an exchange facilitator regarding Colorado property.

(II) "Exchange facilitator" does not include:

(A) The taxpayer or disqualified person, as defined under 26 CFR 1.1031 (k)-1 (k), seeking to qualify for the nonrecognition provisions of 26 U.S.C. sec. 1031;

(B) A bank, savings bank, savings and loan association, building and loan association, or credit union; a bank or savings association holding company organized under the laws of any state, the District of Columbia, a territory or protectorate of the United States, or the United States, subject to regulation and supervision by a federal banking agency; an operating subsidiary of such entities; or an employee or exclusive agent of any of such entities, including, without limitation, a subsidiary that is owned or controlled by such entities;

(C) A person who advertises for and teaches seminars or classes for, or gives presentations to, attorneys, accountants, real estate professionals, tax professionals, or other professionals, where the primary purpose is to teach the professionals about tax-deferred exchanges or train them to act as exchange facilitators;

(D) An exchange facilitator, as defined in 26 CFR 1.1031 (k)-1 (g) (4), whose sole business in this state as an exchange facilitator consists of holding exchange funds from the disposition of relinquished property located outside this state; or

(E) An entity that is wholly owned by an exchange facilitator or is wholly owned by the owner of an exchange facilitator and is used by that exchange facilitator to facilitate exchanges or to take title to Colorado property as an exchange accommodation titleholder, as defined in federal internal revenue service revenue procedure 2000-37.

(III) For purposes of this paragraph (c), "fee" means compensation of any nature, direct or indirect, monetary or in-kind, that is received by a person or a related person as defined in 26 U.S.C. sec. 1031 (f) (3) for any services relating to or incidental to the exchange of like-kind property under 26 U.S.C. sec. 1031.

(d) "Like-kind exchange" means a section 1031 exchange that is subject to 26 U.S.C. sec. 1031.

(e) "Publicly traded company" means a corporation whose securities are publicly traded on a stock exchange that is regulated by the United States securities and exchange commission. The term "publicly traded company" also includes all subsidiaries of such publicly traded company.

(f) "Section 1031 exchange" means an exchange conducted pursuant to 26 U.S.C. sec. 1031 that allows investors to defer the tax on capital gains.

(g) "Taxpayer exchange funds" or "exchange funds" means money a taxpayer entrusts to an exchange facilitator.

(3) **Deceptive trade practices.** A person engages in a deceptive trade practice when a person acts as an exchange facilitator and:

(a) (I) Except as specified in subparagraph (III) of this paragraph (a), fails to notify all current clients of any change in control of the exchange facilitator within two business days after the effective date of the change by:

(A) Facsimile, e-mail transmission, or first-class mail; and

(B) Posting such notice on the exchange facilitator's web site for a period ending not sooner than ninety days after the change in control.

(II) The notice required in subparagraph (I) of this paragraph (a) shall specify the name, address, and other contact information of the transferees.

(III) If the exchange facilitator is a publicly traded company and remains a publicly traded company after a change in control, the exchange facilitator need not notify its client of the change in control.

(IV) For purposes of this paragraph (a), "change in control" means any transfer within twelve months of more than fifty percent of the assets or ownership interests, directly or indirectly, of the exchange facilitator.

(b) (I) Fails to maintain adequate financial assurance and errors and omissions insurance or deposits. An exchange facilitator may maintain bonds, insurance policies, deposits, or irrevocable letters of credit in excess of the amounts required by this subparagraph (I). An exchange facilitator shall at all times:

(A) Maintain a fidelity bond or bonds executed by an insurer authorized to do business in this state in the amount of at least one million dollars and maintain a policy of errors and omissions insurance, in an amount of at least two hundred fifty thousand dollars, executed by an insurer authorized to do business in this state;

(B) Deposit an amount of cash or irrevocable letters of credit in an amount of at least the sum of the amounts specified in sub-subparagraph (A) of this subparagraph (I) in an interest-bearing deposit account or in a money market account with a financial institution of the exchange facilitator's choice, with the interest earned on such account accruing to the exchange facilitator; or

(C) Deposit all exchange funds in a qualified escrow or qualified trust as those terms are defined under 26 CFR 1.1031(k)-1 (g) (3) with a financial institution and provide that any withdrawals from such qualified escrow or qualified trust require the taxpayer's and the exchange facilitator's written authorization.

(II) A person claiming to have sustained damage by reason of the failure of an exchange facilitator to comply with this section may file a claim to recover damages from the bond or deposit described in this paragraph (b).

(c) Fails to act as a custodian for all exchange funds, including money, Colorado property, other consideration, or instruments received by the exchange facilitator from or on behalf of the taxpayer, except funds received as the exchange facilitator's compensation. As used in this paragraph (c), "custodian" means a person who has the same responsibilities as a fiduciary under Colorado law to protect and preserve assets and shall not mean a person who has the same responsibilities as a fiduciary under Colorado law to increase assets or to accomplish other fiduciary duties. Exchange funds are not subject to execution or attachment on any claim against an exchange facilitator. An exchange facilitator shall not knowingly keep or cause to be kept any money in a financial institution under any name designating the money as belonging to a taxpayer unless the money equitably belongs to the taxpayer and was actually entrusted to the exchange facilitator by the taxpayer. Taxpayer exchange funds in excess of two hundred fifty thousand dollars shall be invested or deposited in such manner as to require both the taxpayer's and the exchange facilitator's commercially reasonable means of authorization for withdrawal, including: The taxpayer's delivery to the exchange facilitator of the taxpayer's authorization to disburse exchange funds, and the exchange facilitator's delivery to the depository of the exchange facilitator's authorization to disburse exchange funds; or delivery to the depository of both the taxpayer's and the exchange facilitator's authorizations to disburse exchange funds. An exchange facilitator shall provide the taxpayer with written notification of the manner in which the exchange funds will be invested or deposited, shall invest or deposit exchange funds for the benefit of the taxpayer in investments that meet a standard of care that an ordinarily prudent investor would use when dealing with the property of another, and shall

satisfy investment goals of liquidity and preservation of principal. For purposes of this paragraph (c), a prudent investor standard of care shall be deemed to have been violated if:

(I) A taxpayer's exchange funds are commingled by the exchange facilitator with the operating accounts of the exchange facilitator or with the exchange funds of another taxpayer; except that an exchange facilitator may aggregate exchange funds. For purposes of this subparagraph (I):

(A) "Aggregate" means to combine exchange funds of multiple taxpayers for investment purposes to achieve common investment goals and efficiencies. Exchange funds that have been aggregated into common investments shall be readily identifiable by the financial institution or other regulated investment custodian holding the funds as to each taxpayer for whom they are held through an accounting or subaccounting system.

(B) "Commingle" means to mix together exchange funds of taxpayers with other funds belonging to or under the control of the exchange facilitator in such a manner that a taxpayer's exchange funds cannot be distinguished from other funds belonging to or under the control of the exchange facilitator.

(II) Exchange funds are loaned or otherwise transferred to any person or entity affiliated with the exchange facilitator; except that this subparagraph (II) shall not apply to a transfer or loan made to a financial institution that is the parent of or affiliated with the exchange facilitator or from an exchange facilitator to an exchange accommodation titleholder, as defined in federal internal revenue service revenue procedure 2000-37, as required under the section 1031 exchange contract; or

(III) Exchange funds are invested in a manner that does not provide sufficient liquidity to meet the exchange facilitator's contractual obligations to the taxpayer and does not preserve the principal of the exchange funds. The deposit of funds in a financial institution exempted from this section pursuant to sub-subparagraph (B) of subparagraph (II) of paragraph (c) of subsection (2) of this section shall be deemed to be sufficiently liquid to meet the requirements of this subparagraph (III).

(d) Commits any of the following:

(I) Knowingly makes any material misrepresentation concerning an exchange facilitator's transaction that is intended to mislead another;

(II) Pursues a continued or flagrant course of misrepresentation or makes false statements through advertising or otherwise;

(III) Fails, within a reasonable time, to account for any money or property belonging to others that may be in the possession or under the control of the exchange facilitator;

(IV) Engages in any conduct constituting fraudulent or dishonest dealing;

(V) Is convicted of, or, in the case of an entity, one or more of its owners, officers, directors, or employees who has access to exchange funds is convicted of, any crime involving fraud, misrepresentation, deceit, embezzlement, misappropriation of funds, robbery, or other theft of property; except that commission of such crime by an officer, director, or employee of an exchange facilitator shall not be considered a violation of this subparagraph (V) if the employment or appointment of the officer, director, or employee has been terminated and no clients of the exchange facilitator were harmed or full restitution has been made to all harmed clients;

(VI) Wilfully fails to fulfill an exchange facilitator's contractual duties to the taxpayer to deliver property or funds to the taxpayer unless such failure is due to circumstances beyond the control of the exchange facilitator;

(VII) Materially violates this section or aids, abets, or knowingly permits any person to violate this section;

(VIII) Commits an act that does not meet generally accepted standards of practice for ordinarily prudent investors or fails to perform an act necessary to meet generally accepted standards of practice for ordinarily prudent investors;

(IX) Fails to keep appropriate business and transaction records, falsifies such records, or knowingly and wilfully makes incorrect entries of an essential nature on such records; except that an exchange facilitator may dispose of records after a reasonable time pursuant to the exchange facilitator's document retention and document destruction policy;

(X) Is disciplined in any way by a national certifying agency or by a regulatory agency of another jurisdiction for conduct that relates to the person's employment as an exchange facilitator; or

(XI) Is convicted of or pleads guilty or nolo contendere to a felony or any crime defined in title 18, C.R.S., that relates to the person's employment as an exchange facilitator. A certified copy of the judgment of a court of competent jurisdiction of the conviction or plea shall be prima facie evidence of the conviction or plea.

Source: L. 2009: Entire section added, (HB 09-1254), ch. 116, p. 487, § 1, effective April 16.

6-1-722. Gift certificates - validity - exemptions - definitions. (1) (a) As used in this section, "gift card" means a prefunded tangible or electronic record of a specific monetary value evidencing an issuer's agreement to provide goods, services, credit, money, or anything of value. A "gift card" includes, but is not limited to, a tangible card; electronic card; stored-value card; or certificate or similar instrument, card, or tangible record, all of which contain a microprocessor chip, magnetic chip, or other means for the storage of information and for which the value is decremented upon each use. A "gift card" does not include a prefunded tangible or electronic record issued by, or on behalf of, any government agency; a gift certificate that is issued only on paper; a prepaid telecommunications or technology card; a card or certificate issued to a consumer pursuant to an awards, loyalty, or promotional program for which no money or other item of monetary value was exchanged; or a card that is donated or sold below face value at a volume discount to an employer or charitable organization for fundraising purposes.

(b) This section shall not apply to gift cards that are usable with multiple sellers of goods or services. This exception shall not apply to a gift card usable only with affiliated sellers of goods or services.

(2) On and after August 11, 2010, the issuer shall redeem the remaining value of a gift card for cash if the amount remaining is five dollars or less on request of the holder.

(3) It is unlawful for any person or entity to sell to a purchaser a gift card that contains a service fee, a dormancy fee, an inactivity fee, a maintenance fee, or any other type of fee.

(4) A violation of this section shall be deemed a deceptive trade practice as provided in section 6-1-105 (1) (ccc).

Source: L. 2010: Entire section added, (SB 10-155), ch. 180, p. 647, § 1, effective August 11.

6-1-723. Cathinone bath salts - deceptive trade practice. (1) It is unlawful for any person or entity to distribute, dispense, manufacture, or sell to a purchaser any product that is labeled as a bath salt or any other trademark if the product contains any amount of any cathinones, as defined in section 18-18-102 (3.5), C.R.S.

(2) A violation of this section shall be deemed a deceptive trade practice as provided in section 6-1-105 (1) (e), and the violator shall be subject to a civil penalty as described in section 6-1-112 (1) (d) in addition to any applicable criminal penalty.

Source: L. 2012: Entire section added, (HB 12-1310), ch. 268, p. 1406, § 32, effective June 7.

PART 8

SWEEPSTAKES AND CONTESTS

6-1-801. Legislative finding, declaration, and intent. (1) The general assembly hereby finds, determines, and declares that a vast number of sweepstakes and contests have been and are being directed to Colorado consumers; that Colorado consumers may have paid millions of dollars to purchase goods or services to enter sweepstakes and contests

based on representations created by the sponsors of those sweepstakes and contests; that these sweepstakes and contests may be targeted to certain vulnerable Colorado consumers; that there is a compelling need to curtail and prevent the most deceptive practices in connection with the promotion of sweepstakes and contests; that there is a compelling need for more complete disclosure of rules and operation of sweepstakes and contests in which money or other valuable consideration may be solicited; that preventing the deceptive promotions of sweepstakes and contests is a matter vitally affecting the public interest; and, therefore, that statutory regulation of sweepstakes and contests is necessary to the general welfare of the public.

(2) It is the intent of the general assembly to require that Colorado consumers be provided with all relevant information necessary to make an informed decision concerning sweepstakes and contests. It is also the intent of the general assembly to prohibit misleading and deceptive prize promotions. The terms of this part 8 shall be construed liberally in order to achieve this purpose.

Source: L. 2000: Entire part added, p. 861, § 1, effective August 2.

6-1-802. Definitions. As used in this part 8, unless the context otherwise requires:

(1) "Contest" means any game, puzzle, competition, or plan that holds out or offers to prospective participants the opportunity to receive or compete for gifts, prizes, or gratuities as determined by skill or any combination of chance and skill; except that "contest" shall not be construed to include any activity of licensees regulated under article 9 or article 47.1 of title 12, C.R.S., or part 2 of article 35 of title 24, C.R.S.

(2) "No purchase necessary message" means the following statement, set apart and in bold-faced type, and at least ten-point type: "No purchase or payment of any kind is necessary to enter or win this [sweepstakes or contest].".

(3) "Official rules" means the formal printed statement of the rules for the sweepstakes or contest, which statement shall be printed in contrasting type face at least ten-point type.

(4) "Prize" means cash or an item or service of monetary value that is offered or awarded to a person in a real or purported sweepstakes or contest.

(5) "Prize notice" means a written notice, other than an advertisement appearing in a magazine or newspaper of general circulation, delivered by the United States postal service or by a private carrier, that is or contains a representation that the recipient will receive, or may be or may become eligible to receive, a prize.

(6) "Represent" and "representation" includes express statements and the implications and inferences that would be drawn from those statements, taking into account the context in which the representation is made, including, but not limited to, emphasis, font, size, color, location, and presentation of the representation and any qualifying language. If the representation is made on or visible through a mailing envelope, the context in which the representation is to be considered, including any qualifying language, shall be limited to that which is visible without opening the mailing envelope.

(7) "Retail value" of a prize means:

(a) A price at which the sponsor can demonstrate that a substantial number of the prizes or substantially similar items have been sold to the public in this state by someone other than the sponsor during the preceding year; or

(b) If the sponsor is unable to satisfy the requirement in paragraph (a) of this subsection (7), then the retail value is no more than one and one-half times the amount that the sponsor paid or would pay for the prize in a bona fide purchase from a seller unaffiliated with the sponsor.

(8) "Specially selected" means a representation that a person is a winner, a finalist, in first place or tied for first place, or otherwise among a limited group of persons with an enhanced likelihood of receiving a prize.

(9) "Sponsor" means a person who offers, by means of a prize notice, a prize to another person in this state in conjunction with any real or purported sweepstakes or contest that requires or allows, or creates the impression of requiring or allowing, the person to purchase any goods or services or pay any money as a condition of receiving, or in conjunction with

allowing the person to receive, use, compete for, or obtain a prize or information about a prize.

(10) "Sweepstakes" means any competition, giveaway, drawing, plan, or other selection process or other enterprise or promotion in which anything of value is awarded to participants by chance or random selection that is not otherwise unlawful under other provisions of law; except that "sweepstakes" shall not be construed to include any activity of licensees regulated under article 9 or article 47.1 of title 12, C.R.S., or part 2 of article 35 of title 24, C.R.S.

Source: L. 2000: Entire part added, p. 862, § 1, effective August 2.

6-1-803. Prohibited practices and required disclosures. (1) No sponsor shall require a person to pay the sponsor money or any other consideration as a condition of awarding the person a prize, or as a condition of allowing the person to receive, use, compete for, or obtain a prize or information about a prize.

(2) No sponsor shall represent that a person has won or unconditionally will be the winner of a prize or use language that may lead a person to believe he or she has won a prize, unless all of the following conditions are met:

(a) The person shall be given the prize without obligation;

(b) The person shall be notified at no expense to such person within fifteen days of winning a prize; and

(c) The representation is not false, deceptive, or misleading.

(3) If a sponsor offers one or more items of the same or substantially the same value to all or substantially all of the recipients of a prize notice, the sponsor shall not:

(a) Represent that such items are prizes or that the process by which such items are to be distributed is a sweepstakes or contest, or otherwise represent that such process involves a distribution by chance; or

(b) Represent that the recipient is or has been specially selected unless it is true.

(4) No sponsor shall represent that a person has been specially selected in connection with a sweepstakes or contest unless it is true.

(5) No sponsor shall represent that a person may be or may become a winner of a prize, characterize the person as a possible winner of a prize, or represent that the person will, upon the satisfaction of some condition or the occurrence of some event or other contingency, become the winner of a prize, unless each of the following is clearly and conspicuously disclosed:

(a) The material conditions necessary to make the representation truthful and not misleading, including but not limited to the conditions that must be satisfied in order for the person to be determined as the winner. All such conditions shall be:

(I) Presented in such a manner that they are an integral part of the representation and not separated from the remainder of the representation by intervening words, graphics, colors, or excessive blank space;

(II) Made in terms, syntax, and grammar that are as simple and easy to understand as those used in the representation; and

(III) Presented in such a manner that they appear in the same type size and in the same type face, color, style, and font as the remainder of the representation.

(b) The fact that the person has not yet won;

(c) The no purchase necessary message;

(d) The retail value of each prize;

(e) The estimated odds of receiving each prize pursuant to paragraph (c) of subsection (6) of this section;

(f) The true name or names of the sponsor, the address of the sponsor's actual principal place of business, and the address at which the sponsor may be contacted;

(g) If receipt of a prize is subject to a restriction, a statement that a restriction applies and a description of the restriction;

(h) The deadline for submission of an entry to be eligible to win each prize;

(i) If a sponsor represents that the person is or has been specially selected, and if the representation is not prohibited under subsections (3) and (4) of this section, then imme-

diately adjacent to such representation, in the same type size and boldness as the representation, a statement of the maximum number of persons in the group or purported group of persons with this enhanced likelihood of receiving a prize;

(j) The official rules for the sweepstakes or contest.

(6) Unless otherwise provided by subsection (5) of this section, the information required by subsection (5) of this section shall be presented in the following form:

(a) The information required by paragraphs (b) to (h) of subsection (5) of this section may be presented either:

(I) Immediately adjacent to the first identification of the prize to which it refers and in the same type size and boldness as the reference to the prize; or

(II) In a separate section of official rules with a section entitled "consumer disclosure", which title shall be printed in no less than twelve-point, bold-faced type, which section shall contain only a description of the prize, and which text shall be printed in no less than ten-point type.

(b) In addition to the other requirements of this subsection (6), the no purchase necessary message shall be presented in the official rules and, if the official rules do not appear thereon, on any device by which a person enters a sweepstakes or contest or purchases any goods or services or pays any money in connection with a sweepstakes or contest. The no purchase necessary message included in the official rules shall be set out in a separate paragraph in the official rules and be printed in capital letters in contrasting type face not smaller than the largest type face used in the text of the official rules. If a person is required or allowed to enter the sweepstakes or contest, or purchase any goods or services or pay any money in connection with a sweepstakes or contest, through a telephone call, the no purchase necessary message must be read to the person during the telephone call prior to accepting the entry, purchase, or payment.

(c) The statement of the odds of receiving each prize shall include, for each prize, the total number of prizes to be given away and the estimated odds of winning each prize based upon the following formula: "____ [number of prizes] out of _____ prize notices distributed".

(d) All dollar values shall be stated in Arabic numerals and be preceded by a dollar sign.

(7) No sponsor shall subject sweepstakes or contest entries not accompanied by an order for products or services to any disability or disadvantage in the winner selection process to which an entry accompanied by an order for products or services would not be subject.

(8) No sponsor shall represent that an entry in a sweepstakes or contest accompanied by an order for products or services will be eligible to receive additional prizes or be more likely to win than an entry not accompanied by an order for products or services, or that an entry not accompanied by an order for products or services will have a reduced chance of winning a prize in the sweepstakes or contest.

(9) No sponsor shall represent that a person will have an increased chance of receiving a prize by making multiple or duplicate purchases, payments, or donations, or by entering a sweepstakes or contest more than one time.

(10) No sponsor shall represent that a person is being notified a second or final time of the opportunity to receive or compete for a prize, unless the representation is true.

(11) No sponsor shall represent that a prize notice is urgent or otherwise convey an impression of urgency by use of description, narrative copy, phrasing on a mailing envelope, or similar method, unless there is a limited time period in which the recipient must take some action to claim or be eligible to receive a prize, and the date by which such action is required appears immediately adjacent to each representation of urgency in the same type size and boldness as each representation of urgency.

(12) No sponsor shall deliver, or cause to be delivered, a prize notice which is in the form of, or a prize notice which includes, a document which simulates a bond, check, or other negotiable instrument, unless that document contains a statement that such document is nonnegotiable and has no cash value.

(13) No sponsor shall deliver, or cause to be delivered, a prize notice which:

(a) Simulates or falsely represents that it is a document authorized, issued, or approved by any court, official, or agency of the United States or any state or by any lawyer, law firm, or insurance or brokerage company; or

(b) Creates a false impression as to its source, authorization, or approval.

(14) No sponsor shall represent that a prize notice is being delivered by any method other than bulk mail unless that is the case or otherwise misrepresent the manner in which the prize notice is delivered.

(15) In the operation of a sweepstakes or contest, no sponsor shall:

(a) Misrepresent in any manner the likelihood or odds of winning any prize or misrepresent in any manner the rules, terms, or conditions of participation in a sweepstakes or contest;

(b) Fail to clearly and conspicuously disclose with all contest puzzles and games all of the following in the rules:

(I) The number of rounds or levels which may be necessary to complete the contest and determine winners;

(II) Whether future puzzles or games, if any, or tie breakers, if any, will be significantly more difficult than the initial puzzle;

(III) The date or dates on or before which the contest will terminate and upon which all prizes will be awarded;

(IV) The method of determining prizewinners if a tie remains after the last tie breaker puzzle is completed; and

(V) All rules, regulations, terms, and conditions of the contest.

(16) The prohibited practices listed in this section are in addition to and do not limit the types of unfair trade practices actionable at common law or under other civil and criminal statutes of this state.

(17) No sponsor, requiring a person to respond in any manner to claim a prize, shall require the person to purchase insurance; except that the sponsor is in no way responsible for applicable state and federal taxes on the prize; and except that a sponsor may require proof of health insurance in order to claim a prize for travel or recreational activities. Such health insurance may not be acquired from the sponsor.

Source: L. 2000: Entire part added, p. 863, § 1, effective August 2. **L. 2002:** (17) added, p. 383, § 1, effective April 25.

6-1-804. Exemptions. (1) The requirements of section 6-1-803 (5) and (6) shall not apply to solicitations or representations made in connection with the sale of goods:

(a) By a catalog seller that derives at least thirty-seven and one-half percent of its annual revenues from the sale of products sold in connection with the distribution of catalogs of at least twenty-four pages that contain written descriptions or illustrations and sale prices for each item of merchandise, if the catalogs are distributed in more than one state with a total annual distribution of at least two hundred fifty thousand; or

(b) From a membership group or club selling books, periodicals, recordings, videocassettes and similar items that is regulated by the federal trade commission pursuant to 16 CFR 425.1 concerning the use of negative option plans by sellers in commerce.

Source: L. 2000: (1)(a) amended, p. 989, § 108, effective July 1; entire part added, p. 867, § 1, effective August 2.

PART 9

COLORADO NO-CALL LIST ACT

6-1-901. Short title. This part 9 shall be known and may be cited as the "Colorado No-Call List Act".

Source: L. 2001: Entire part added, p. 1454, § 1, effective August 8.

6-1-902. Legislative declaration. (1) The general assembly hereby finds, determines, and declares that:

(a) The use of the telephone and telefacsimile ("fax") to market goods and services is widespread;

(b) Many citizens of this state view telemarketing as an invasion of privacy;

(c) Individuals' privacy rights and commercial freedom of speech should be balanced in a way that accommodates both the privacy of individuals and legitimate telemarketing practices;

(d) Although charitable and political organizations are exempt from the provisions of this part 9 because of considerations of freedom of speech, the general assembly encourages such organizations to voluntarily comply with this part 9 when possible; and

(e) It is in the public interest to establish a mechanism under which the individual citizens of this state can decide whether or not to receive telephone solicitations by phone or fax.

Source: L. 2001: Entire part added, p. 1454, § 1, effective August 8.

6-1-903. Definitions. As used in this part 9, unless the context otherwise requires:

(1) "Caller identification service" means a type of telephone service that permits telephone subscribers to see the telephone number of incoming telephone calls.

(2) "Colorado no-call list" means the database of Colorado residential subscribers and wireless telephone service subscribers that have given notice, in accordance with rules promulgated under section 6-1-905, of such subscribers' objection to receiving telephone solicitations.

(3) "Conforming consolidated no-call list" means any database that includes telephone numbers of telephone subscribers that do not wish to receive telephone solicitations, if such database has been updated within the prior thirty days to include all of the telephone numbers on the Colorado no-call list.

(4) "Conforming list broker" means any person or entity that provides lists for the purpose of telephone solicitation, if such lists shall have removed, at a minimum of every thirty days, any phone numbers that are included on the Colorado no-call list.

(5) "Designated agent" means the party with which the public utilities commission contracts under section 6-1-905 (2).

(6) "Electronic mail" means an electronic message that is transmitted between two or more computers or electronic terminals. "Electronic mail" includes electronic messages that are transmitted within or between computer networks.

(7) (a) "Established business relationship" means a relationship that:

(I) Was formed, prior to the telephone solicitation, through a voluntary, two-way communication between a seller or telephone solicitor and a residential subscriber or wireless telephone service subscriber, with or without consideration, on the basis of an application, purchase, ongoing contractual agreement, or commercial transaction between the parties regarding products or services offered by such seller or telephone solicitor; and

(II) Has not been previously terminated by either party; and

(III) Currently exists or has existed within the immediately preceding eighteen months.

(b) "Established business relationship", with respect to a financial institution or affiliate, as those terms are defined in section 527 of the federal "Gramm-Leach-Bliley Act", includes any situation in which a financial institution or affiliate makes solicitation calls related to other financial services offered, if the financial institution or affiliate is subject to the requirements regarding privacy of Title V of the federal "Gramm-Leach-Bliley Act", and the financial institution or affiliate regularly conducts business in Colorado.

(8) "Internet" means the international computer network consisting of federal and nonfederal, interoperable, packet-controlled switched data networks.

(9) "Residential subscriber" means a person who has subscribed to residential telephone service with a local exchange provider, as defined in section 40-15-102 (18), C.R.S. "Person" also includes any other persons living or residing with such person.

(10) (a) "Telephone solicitation" means any voice, telefacsimile, graphic imaging, or data communication, including text messaging communication over a telephone line or through a wireless telephone for the purpose of encouraging the purchase or rental of, or investment in, property, goods, or services.

(b) Notwithstanding paragraph (a) of this subsection (10), "telephone solicitation" does not include communications:

(I) To any residential subscriber or wireless telephone service subscriber with the subscriber's prior express invitation or permission;

(II) By or on behalf of any person or entity with whom a residential subscriber or wireless telephone service subscriber has an established business relationship;

(III) For thirty days after a residential subscriber or wireless telephone service subscriber has contacted a business to inquire about the potential purchase of goods or services or until the subscriber requests that no further calls be made, whichever occurs first;

(IV) By or on behalf of a charitable organization that is required to comply and that has complied with the notice and reporting requirements of section 6-16-104 or is excluded from such notice and reporting requirements by section 6-16-104 (6);

(V) Made for the sole purpose of urging support for or opposition to a political candidate or ballot issue; or

(VI) Made for the sole purpose of conducting political polls or soliciting the expression of opinions, ideas, or votes.

(c) "Telephone solicitation" includes any communication described in paragraph (a) of this subsection (10), whether such communication originates from a live operator, through the use of automatic dialing and recorded message equipment, or by other means.

(11) "Wireless telephone" means a telephone that operates without a physical, wireline connection to the provider's equipment. The term includes, without limitation, cellular and mobile telephones.

(12) "Wireless telephone service subscriber" means a person who has subscribed to a telephone service that does not employ a wireline telephone or that employs both wireline and wireless telephones on the same customer account.

Source: L. 2001: Entire part added, p. 1455, § 1, effective August 8. **L. 2003:** (2), (7)(a)(I), (10)(a), (10)(b)(I), (10)(b)(II), and (10)(b)(III) amended and (11) and (12) added, p. 771, § 1, effective March 25. **L. 2004:** (7)(b) amended, p. 1188, § 7, effective August 4. **L. 2008:** (10)(b)(IV) amended, p. 1879, § 7, effective August 5.

Cross references: For the "Gramm-Leach-Bliley Act", see Pub.L. 106-102, 113 Stat. 1338.

ANNOTATION

"Residential subscriber" defined. A "residential subscriber", for purposes of the No-Call List Act, is a person who has subscribed to residential telephone service and has added that number to the Colorado no-call list. The act contains no exceptions or qualifying language based on the use of the number for business purposes. Holcomb v. Steven D. Smith, Inc., 170 P.3d 815 (Colo. App. 2007).

Nothing suggests that using a no-call listed telephone number for business purposes or permitting it to appear on commercial telephone listings causes an otherwise qualifying "residential subscriber" to somehow lose the protections of the act. Holcomb v. Jan-Pro Cleaning Sys., 172 P.3d 888 (Colo. 2007).

6-1-904. Unlawful to make telephone solicitations to subscribers on the Colorado no-call list - requirements for telephone solicitations generally. (1) (a) No person or entity shall make or cause to be made any telephone solicitation to the telephone of any residential subscriber or wireless telephone service subscriber in this state who has added his or her telephone number and zip code to the Colorado no-call list in accordance with rules promulgated under section 6-1-905.

(b) Any person or entity that makes a telephone solicitation to the telephone of any

residential subscriber or wireless telephone service subscriber in this state shall register in accordance with the provisions of section 6-1-905 (3) (b) (II).

(2) Repealed.

(3) No person or entity that makes a telephone solicitation to the telephone of a residential subscriber or a wireless telephone service subscriber in this state shall knowingly utilize any method to block or otherwise circumvent such subscriber's use of a caller identification service when that person or entity's service or equipment is capable of allowing the display of the number.

(4) Persons or entities desiring to make telephone solicitations shall update their copies of the Colorado no-call list, conforming consolidated no-call list, or a list obtained from a conforming list broker within thirty days after the beginning of every calendar quarter, on or after July 1, 2002, or upon the initial availability and accessibility of the Colorado no-call list, whichever is earlier.

Source: L. 2001: Entire part added, p. 1457, § 1, effective August 8. **L. 2003:** (1), (2), and (3) amended, p. 772, § 2, effective March 25. **L. 2007:** (2) repealed, p. 2018, § 6, effective June 1.

ANNOTATION

No implied exception for dual use of number. A "residential subscriber", for purposes of the No-Call List Act, is a person who has subscribed to residential telephone service and has added that number to the Colorado no-call list. The act contains no exceptions or qualifying language based on the use of the number for business purposes. Holcomb v. Steven D. Smith, Inc., 170 P.3d 815 (Colo. App. 2007).

6-1-905. Establishment and operation of a Colorado no-call list. (1) The Colorado no-call list program is hereby created for the purpose of establishing a database to use when verifying residential subscribers and wireless telephone service subscribers in this state who have given notice, in accordance with rules promulgated under paragraph (b) of subsection (3) of this section, of such subscribers' objection to receiving telephone solicitations. The program shall be administered by the public utilities commission.

(2) Not later than January 1, 2002, the public utilities commission shall contract with a designated agent, which shall maintain the web site and database containing the Colorado no-call list. If no more than one entity bids on the contract, the public utilities commission may award, at its discretion, such contract.

(3) (a) Not later than July 1, 2002, the designated agent, using the designated state internet web site, shall develop and maintain the Colorado no-call list database with information provided by residential subscribers and, as soon as practicable after March 25, 2003, shall include information provided by wireless telephone service subscribers.

(b) The public utilities commission shall establish, by rule, guidelines for the designated agent for the development and maintenance of the Colorado no-call list so that the no-call list can easily be accessed by persons or entities desiring to make telephone solicitations, and by state and local law enforcement agencies. As soon as practicable after March 25, 2003, the public utilities commission shall promulgate rules that:

(I) Specify that there shall be no cost for a residential subscriber or wireless telephone service subscriber to provide notification to the designated agent that such subscriber objects to receiving telephone solicitations;

(II) Specify that there shall be an annual registration fee of not more than five hundred dollars for persons or entities that wish to make telephone solicitations or otherwise access the database of telephone numbers and zip codes contained in the Colorado no-call list database. The public utilities commission shall determine such fee on a sliding scale so that persons or entities with fewer than five employees shall pay no fee. In addition, there shall be no fee charged to conforming list brokers or nonprofit corporations, as defined in section 7-121-401 (26), C.R.S. The maximum fee shall be charged only to persons or entities with more than one thousand employees. Moneys collected from such fees shall cover the direct and indirect costs related to the creation and operation of the Colorado no-call list. Moneys

from such fees shall be collected by and paid directly to the designated agent. The public utilities commission shall have the authority to annually adjust the fees below the stated maximum based on revenue history of the fees received by the designated agent. The designated agent shall provide means for on-line registration and credit card payment of fees charged pursuant to this subparagraph (II). Each such person or entity shall provide a current business name, business address, e-mail address if available, and telephone number when initially registering for the no-call list. This information shall be updated when changes occur.

(III) Specify that the method by which each residential subscriber and wireless telephone service subscriber may give notice to the designated agent of his or her objection to receiving such solicitations, or may revoke such notice, shall be exclusively by entering the area code, phone number, and zip code of the subscriber directly into the database via the designated state internet web site or by using a touch-tone phone to enter the area code, phone number, and zip code of the subscriber via a designated statewide, toll-free telephone number maintained by the designated agent as a part of the Colorado no-call list;

(IV) Specify that the date of every notice received in accordance with subparagraph (III) of this paragraph (b) be recorded and included as part of the information in the no-call list;

(V) Require the designated agent to provide updated information about the Colorado no-call list program on the designated state web site, subject to supervision by the public utilities commission;

(VI) Prohibit the designated agent or any person or entity collecting information to be transmitted to the designated agent from making any use or distribution of subscriber information contained in the no-call list except as expressly authorized under this part 9;

(VII) Specify the methods by which additions, deletions, changes, and modifications shall be made to the Colorado no-call list database and how updates of the database shall be made available to persons or entities desiring such updates. Such methods shall include provisions to remove from the Colorado no-call list, on at least an annual basis, any telephone number that has been disconnected or reassigned.

(VIII) Require the designated agent to maintain an automated, on-line complaint system for residential subscribers and wireless telephone service subscribers to report suspected violations over the internet web site. The automated, on-line complaint system shall have the capability to collect, sort, and report suspected violations to the appropriate state enforcement agency electronically for enforcement purposes.

(IX) Specify that the no-call list shall be available on line at the Colorado no-call list web site to a person or entity desiring to make telephone solicitations if the person or entity has registered in accordance with the provisions of subparagraph (II) of this paragraph (b). The list shall be available in a text or other compatible format, at the discretion of the public utilities commission, but shall allow telephone solicitors to select and sort by specific zip codes and telephone area codes. Telephone solicitors and conforming list brokers shall not receive additional compensation for distributing the Colorado no-call list, but are encouraged to freely distribute the Colorado no-call list at no cost.

(X) Specify such other matters relating to the database as the public utilities commission deems necessary or desirable.

(c) If the federal government establishes one or more official databases of residential or wireless telephone service subscribers who object to receiving telephone solicitations, the designated agent is authorized to provide appropriate data from the official Colorado no-call list exclusively for inclusion in an official, national do-not-call database. To the extent allowed by federal law, the designated agent shall ensure that the Colorado no-call list includes that portion of an official national do-not-call database that relates to Colorado.

(4) The state shall not be liable to any person for gathering, managing, or using information in the Colorado no-call list database pursuant to this part 9 and for enforcing the provisions of this part 9.

(5) The designated agent shall not be liable to any person for performing its duties under this part 9 unless, and only to the extent that, the designated agent commits a willful and wanton act or omission.

(6) As soon as practicable after March 25, 2003, the designated agent shall update the database, on an ongoing basis, with information provided by residential subscribers, wireless telephone service subscribers, and local exchange providers.

(7) No person shall place the telephone number of another person on the Colorado no-call list without the authorization of the person to whom the number is assigned.

(8) Repealed.

Source: L. 2001: Entire part added, p. 1457, § 1, effective August 8. **L. 2003:** (1), (3)(a), IP(3)(b), (3)(b)(I), (3)(b)(III), (3)(b)(VIII), (3)(c), and (6) amended, p. 773, § 3, effective March 25. **L. 2004:** (8) repealed, p. 585, § 1, effective August 4.

6-1-906. Enforcement - penalties - defenses. (1) On and after July 1, 2002, violation of any provision of this part 9 constitutes a deceptive trade practice under the provisions of section 6-1-105 (1) and may be enforced under sections 6-1-110, 6-1-112, and 6-1-113. No state enforcement action under this part 9 may be brought against a person or entity for fewer than three violations per month.

(2) Notwithstanding subsection (1) of this section, it shall not be a violation of this part 9 if:

(a) The person or entity has otherwise fully complied with the provisions of this part 9 and has established and implemented, prior to the violation, written practices and procedures to effectively prevent telephone solicitations in violation of this part 9; or

(b) The violation resulted from an error in transcription or other technical defect, not the fault of the person or entity, that caused the information in the no-call list as received by the person or entity to differ from the information that was or should have been included in the no-call list as transmitted by the designated agent.

(3) The remedies, duties, prohibitions, and penalties of this section are not exclusive and are in addition to all other causes of action, remedies, and penalties provided by law.

(4) No provider of telephone caller identification service shall be held liable for violations of this part 9 committed by other persons or entities.

Source: L. 2001: Entire part added, p. 1460, § 1, effective August 8.

6-1-907. Acceptance of gifts, grants, and donations. The public utilities commission may accept and expend moneys from gifts, grants, and donations for purposes of administering the provisions of this part 9.

Source: L. 2001: Entire part added, p. 1460, § 1, effective August 8.

6-1-908. Severability. If any provision of this part 9 or the application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of this part 9 which can be given effect without the invalid provision or application, and to this end the provisions of this part 9 are declared to be severable.

Source: L. 2001: Entire part added, p. 1460, § 1, effective August 8.

PART 10

RESTRICTIONS ON USE OF LOAN INFORMATION - SOLICITATIONS

6-1-1001. Restrictions on use of loan information for solicitations. (1) A person shall not reference the trade name or trademark of a lender or a trade name or trademark confusingly similar to that of a lender in a solicitation for the offering of services or products without the consent of the lender unless the solicitation clearly and conspicuously states in bold-faced type on the front page of the correspondence containing the solicitation:

(a) The name, address, and telephone number of the person making the solicitation;

(b) That the person making the solicitation is not affiliated with the lender;

(c) That the solicitation is not authorized or sponsored by the lender; and

(d) That the loan information referenced was not provided by the lender.

(2) A person shall not reference a loan number, loan amount, or other specific loan information that is not publicly available in a solicitation for the purchase of services or products; except that this prohibition shall not apply to communications by a lender or its affiliates with a current customer of the lender or with a person who was a customer of the lender.

(3) (a) A person shall not reference a loan number, loan amount, or other specific loan information that is publicly available in a solicitation for the purchase of services or products unless the communication clearly and conspicuously states in bold-faced type on the front page of the correspondence containing the solicitation:

(I) The name, address, and telephone number of the person making the solicitation;

(II) That the person making the solicitation is not affiliated with the lender;

(III) That the solicitation is not authorized or sponsored by the lender; and

(IV) That the loan information referenced was not provided by the lender.

(b) The prohibition in paragraph (a) of this subsection (3) shall not apply to communications by a lender or its affiliates with a current customer of the lender or with a person who was a customer of the lender.

(4) Any reference to an existing lender without the consent of the lender, and any reference to a loan number, loan amount, or other specific loan information, appearing on the outside of an envelope, visible through the envelope window, or on a postcard, in connection with any written communication that includes or contains a solicitation for goods or services is prohibited.

(5) It is not a violation of this section for a person to use the trade name of another lender in an advertisement for services or products to compare the services or products offered by the other lender.

(6) A lender or owner of a trade name or trademark may seek an injunction against a person who violates this section to stop the unlawful use of the trade name, trademark, or loan information. The person seeking the injunction shall not have to prove actual damage as a result of the violation. Irreparable harm and interim harm to the lender or owner shall be presumed. The lender or owner seeking the injunction may seek to recover actual damages and any profits the defendant has accrued as a result of the violation. The prevailing party in any action brought pursuant to this section is entitled to recover costs associated with the action and reasonable attorney fees from the other party.

(7) For the purposes of this section, "lender" means a bank, industrial bank, savings and loan association, savings bank, credit union, finance company, mortgage bank, mortgage broker, loan originator or holder of the loan, or other person who makes loans in this state, and any affiliate thereof, or any third party operating with the consent of the lender. For the purposes of this section, a person shall not be considered a lender based on the person's former employment with a lender.

(8) Nothing in this section shall apply to title insurance.

Source: L. 2004: Entire part added, p. 1533, § 1, effective August 4.

PART 11

COLORADO FORECLOSURE PROTECTION ACT

SUBPART 1

GENERAL PROVISIONS

6-1-1101. Short title. This part 11 shall be known and may be cited as the "Colorado Foreclosure Protection Act".

Source: L. 2006: Entire part added, p. 1330, § 1, effective May 30.

6-1-1102. Legislative declaration. The general assembly hereby finds, determines, and declares that home ownership and the accumulation of equity in one's home provide significant social and economic benefits to the state and its citizens. Unfortunately, too many home owners in financial distress, especially the poor, elderly, and financially unsophisticated, are vulnerable to a variety of deceptive or unconscionable business practices designed to dispossess them or otherwise strip the equity from their homes. There is a compelling need to curtail and to prevent the most deceptive and unconscionable of these business practices, to provide each home owner with information necessary to make an informed and intelligent decision regarding transactions with certain foreclosure consultants and equity purchasers, to provide certain minimum requirements for contracts between such parties, including statutory rights to cancel such contracts, and to ensure and foster fair dealing in the sale and purchase of homes in foreclosure. Therefore, it is the intent of the general assembly that all violations of this part 11 have a significant public impact and that the terms of this part 11 be liberally construed to achieve these purposes.

Source: L. 2006: Entire part added, p. 1330, § 1, effective May 30.

6-1-1103. Definitions. As used in this part 11, unless the context otherwise requires:

(1) "Associate" means a partner, subsidiary, affiliate, agent, or any other person working in association with a foreclosure consultant or an equity purchaser. "Associate" does not include a person who is excluded from the definition of an "equity purchaser" or a "foreclosure consultant".

(2) "Equity purchaser" means a person, other than a person who acquires a property for the purpose of using such property as his or her personal residence, who acquires title to a residence in foreclosure; except that the term does not include a person who acquires such title:

(a) (Deleted by amendment, L. 2010, (HB 10-1133), ch. 350, p. 1615, § 1, effective January 1, 2011.)

(b) By a deed in lieu of foreclosure to the holder of an evidence of debt, or an associate of the holder of an evidence of debt, of a consensual lien or encumbrance of record if such consensual lien or encumbrance is recorded in the real property records of the clerk and recorder of the county where the residence in foreclosure is located prior to the recording of the notice of election and demand for sale required under section 38-38-101, C.R.S.;

(c) By a deed from the public trustee or a county sheriff as a result of a foreclosure sale conducted pursuant to article 38 of title 38, C.R.S.;

(d) At a sale of property authorized by statute;

(e) By order or judgment of any court;

(f) From the person's spouse, relative, or relative of a spouse, by the half or whole blood or by adoption, or from a guardian, conservator, or personal representative of a person identified in this paragraph (f);

(g) While performing services as a part of a person's normal business activities under any law of this state or the United States that regulates banks, trust companies, savings and loan associations, credit unions, insurance companies, title insurers, insurance producers, or escrow companies authorized to conduct business in the state, an affiliate or subsidiary of such person, or an employee or agent acting on behalf of such person; or

(h) As a result of a short sale transaction in which a short sale addendum form, as promulgated by the Colorado real estate commission, is part of the contract used to acquire a residence in foreclosure and such transaction complies with section 6-1-1121.

(3) "Evidence of debt" means a writing that evidences a promise to pay or a right to the payment of a monetary obligation, such as a promissory note, bond, negotiable instrument, a loan, credit, or similar agreement, or a monetary judgment entered by a court of competent jurisdiction.

(4) (a) "Foreclosure consultant" means a person who does not, directly or through an associate, take or acquire any interest in or title to a homeowner's property and who, in the course of such person's business, vocation, or occupation, makes a solicitation, representation, or offer to a home owner to perform, in exchange for compensation from the home

owner or from the proceeds of any loan or advance of funds, a service that the person represents will do any of the following:

(I) Stop or postpone a foreclosure sale;

(II) Obtain a forbearance from a beneficiary under a deed of trust, mortgage, or other lien;

(III) Assist the home owner in exercising a right to cure a default as provided in article 38 of title 38, C.R.S.;

(IV) Obtain an extension of the period within which the home owner may cure a default as provided in article 38 of title 38, C.R.S.;

(V) Obtain a waiver of an acceleration clause contained in an evidence of debt secured by a deed of trust, mortgage, or other lien on a residence in foreclosure or contained in such deed of trust, mortgage, or other lien;

(VI) Assist the home owner to obtain a loan or advance of funds;

(VII) Avoid or reduce the impairment of the home owner's credit resulting from the recording of a notice of election and demand for sale, commencement of a judicial foreclosure action, or due to any foreclosure sale or the granting of a deed in lieu of foreclosure or resulting from any late payment or other failure to pay or perform under the evidence of debt, the deed of trust, or other lien securing such evidence of debt;

(VIII) In any way delay, hinder, or prevent the foreclosure upon the home owner's residence; or

(IX) Assist the home owner in obtaining from the beneficiary, mortgagee, or grantee of the lien in foreclosure, or from counsel for such beneficiary, mortgagee, or grantee, the remaining or excess proceeds from the foreclosure sale of the residence in foreclosure.

(b) The term "foreclosure consultant" does not include:

(I) A person licensed to practice law in this state, while performing any activity related to the person's attorney-client relationship with a home owner or any activity related to the person's attorney-client relationship with the beneficiary, mortgagee, grantee, or holder of any lien being enforced by way of foreclosure;

(II) A holder or servicer of an evidence of debt or the attorney for the holder or servicer of an evidence of debt secured by a deed of trust or other lien on any residence in foreclosure while the person performs services in connection with the evidence of debt, lien, deed of trust, or other lien securing such debt;

(III) A person doing business under any law of this state or the United States, which law regulates banks, trust companies, savings and loan associations, credit unions, insurance companies, title insurers, insurance producers, or escrow companies authorized to conduct business in the state, while the person performs services as part of the person's normal business activities, an affiliate or subsidiary of any of the foregoing, or an employee or agent acting on behalf of any of the foregoing;

(IV) A person originating or closing a loan in a person's normal course of business if, as to that loan:

(A) The loan is subject to the requirements of the federal "Real Estate Settlement Procedures Act of 1974", as amended, 12 U.S.C. sec. 2601 to 2617; or

(B) With respect to any second mortgage or home equity line of credit, the loan is subordinate to and closed simultaneously with a qualified first mortgage loan under sub-subparagraph (A) of this subparagraph (IV) or is initially payable on the face of the note or contract to an entity included in subparagraph (III) of this paragraph (b);

(V) A judgment creditor of the home owner, if the judgment is recorded in the real property records of the clerk and recorder of the county where the residence in foreclosure is located and the legal action giving rise to the judgment was commenced before the notice of election and demand for sale required under section 38-38-101, C.R.S.;

(VI) A title insurance company or title insurance agent authorized to conduct business in this state, while performing title insurance and settlement services;

(VII) A person licensed as a real estate broker under article 61 of title 12, C.R.S., while the person engages in any activity for which the person is licensed; or

(VIII) A nonprofit organization that solely offers counseling or advice to home owners in foreclosure or loan default, unless the organization is an associate of the foreclosure consultant.

(5) "Foreclosure consulting contract" means any agreement between a foreclosure consultant and a home owner.

(6) "Holder of evidence of debt" means the person in actual possession of or otherwise entitled to enforce an evidence of debt; except that "holder of evidence of debt" does not include a person acting as a nominee solely for the purpose of holding the evidence of debt or deed of trust as an electronic registry without any authority to enforce the evidence of debt or deed of trust. The following persons are presumed to be the holder of evidence of debt:

(a) The person who is the obligee of and who is in possession of an original evidence of debt;

(b) The person in possession of an original evidence of debt together with the proper indorsement or assignment thereof to such person in accordance with section 38-38-101 (6), C.R.S.;

(c) The person in possession of a negotiable instrument evidencing a debt, which has been duly negotiated to such person or to bearer or indorsed in blank; or

(d) The person in possession of an evidence of debt with authority, which may be granted by the original evidence of debt or deed of trust, to enforce the evidence of debt as agent, nominee, or trustee or in a similar capacity for the obligee of the evidence of debt.

(7) "Home owner" means the owner of a dwelling who occupies it as his or her principal place of residence, including a vendee under a contract for deed to real property, as that term is defined in section 38-35-126 (1) (b), C.R.S.

(8) (a) Except as otherwise provided in paragraph (b) of this subsection (8), "residence in foreclosure" means a residence or dwelling, as defined in sections 5-1-201 and 5-1-301, C.R.S., that is occupied as the home owner's principal place of residence and that is encumbered by a residential mortgage loan that is at least thirty days delinquent or in default.

(b) With respect to subpart 3 of this part 11, "residence in foreclosure" means a residence or dwelling, as defined in sections 5-1-201 and 5-1-301, C.R.S., that is occupied as the home owner's principal place of residence, is encumbered by a residential mortgage loan, and against which a foreclosure action has been commenced or as to which an equity purchaser otherwise has actual or constructive knowledge that the loan is at least thirty days delinquent or in default.

(9) "Short sale" or "short sale transaction" means a transaction in which the residence in foreclosure is sold when:

(a) A holder of evidence of debt agrees to release its lien for an amount that is less than the outstanding amount due and owing under such evidence of debt; and

(b) The lien described in paragraph (a) of this subsection (9) is recorded in the real property records of the county where the residence in foreclosure is located.

Source: L. 2006: Entire part added, p. 1331, § 1, effective May 30. **L. 2007:** (4)(b)(IV)(A) amended, p. 2018, § 7, effective June 1. **L. 2008:** (4)(b)(VII) amended, p. 511, § 29, effective April 17. **L. 2009:** (8) amended, (HB 09-1109), ch. 39, p. 154, § 1, effective July 1. **L. 2010:** IP(2), (2)(a), IP(4)(a), (7), and (8) amended and (2)(h) and (9) added, (HB 10-1133), ch. 350, pp. 1615, 1616, §§ 1, 2, effective January 1, 2011.

SUBPART 2

FORECLOSURE CONSULTANTS

6-1-1104. Foreclosure consulting contract. (1) A foreclosure consulting contract shall be in writing and provided to and retained by the home owner, without changes, alterations, or modifications, for review at least twenty-four hours before it is signed by the home owner.

(2) A foreclosure consulting contract shall be printed in at least twelve-point type and shall include the name and address of the foreclosure consultant to which a notice of cancellation can be mailed and the date the home owner signed the contract.

(3) A foreclosure consulting contract shall fully disclose the exact nature of the foreclosure consulting services to be provided and the total amount and terms of any compensation to be received by the foreclosure consultant or associate.

(4) A foreclosure consulting contract shall be dated and personally signed, with each page being initialed, by each home owner and the foreclosure consultant and shall be acknowledged by a notary public in the presence of the home owner at the time the contract is signed by the home owner.

(5) A foreclosure consulting contract shall contain the following notice, which shall be printed in at least fourteen-point bold-faced type, completed with the name of the foreclosure consultant, and located in immediate proximity to the space reserved for the home owner's signature:

Notice Required by Colorado Law

_______ (Name) or (his/her/its) associate cannot ask you to sign or have you sign any document that transfers any interest in your home or property to (him/her/it) or (his/her/its) associate.

_______ (Name) or (his/her/its) associate cannot guarantee you that they will be able to refinance your home or arrange for you to keep your home.

You may, at any time, cancel this contract, without penalty of any kind.

If you want to cancel this contract, mail or deliver a signed and dated copy of this notice of cancellation, or any other written notice, indicating your intent to cancel to _______________ (name and address of foreclosure consultant) at _____________________ (address of foreclosure consultant, including facsimile and electronic mail address).

As part of any cancellation, you (the home owner) must repay any money actually spent on your behalf by ____________________ (name of foreclosure consultant) prior to receipt of this notice and as a result of this agreement, within sixty days, along with interest at the prime rate published by the federal reserve plus two percentage points, with the total interest rate not to exceed eight percent per year.

This is an important legal contract and could result in the loss of your home. Contact an attorney or a housing counselor approved by the federal department of housing and urban development before signing.

(6) A completed form in duplicate, captioned "Notice of Cancellation" shall accompany the foreclosure consulting contract. The notice of cancellation shall:

(a) Be on a separate sheet of paper attached to the contract;

(b) Be easily detachable; and

(c) Contain the following statement, printed in at least fourteen-point type:

Notice of Cancellation

(Date of contract)

To: (name of foreclosure consultant)

(Address of foreclosure consultant, including facsimile and electronic mail)

I hereby cancel this contract.

__________________ (Date)

__________________ (Home owner's signature)

(7) The foreclosure consultant shall provide to the home owner a signed, dated, and acknowledged copy of the foreclosure consulting contract and the attached notice of cancellation immediately upon execution of the contract.

(8) The time during which the home owner may cancel the foreclosure consulting contract does not begin to run until the foreclosure consultant has complied with this section.

Source: L. 2006: Entire part added, p. 1334, § 1, effective May 30. **L. 2010:** (4) amended, (HB 10-1133), ch. 350, p. 1616, § 3, effective January 1, 2011.

6-1-1105. Right of cancellation. (1) In addition to any right of rescission available under state or federal law, the home owner has the right to cancel a foreclosure consulting contract at any time.

(2) Cancellation occurs when the home owner gives written notice of cancellation of the foreclosure consulting contract to the foreclosure consultant at the address specified in the contract or through any facsimile or electronic mail address identified in the contract or other materials provided to the home owner by the foreclosure consultant.

(3) Notice of cancellation, if given by mail, is effective when deposited in the United States mail, properly addressed, with postage prepaid.

(4) Notice of cancellation need not be in the form provided with the contract and is effective, however expressed, if it indicates the intention of the home owner to cancel the foreclosure consulting contract.

(5) As part of the cancellation of a foreclosure consulting contract, the home owner shall repay, within sixty days after the date of cancellation, all funds paid or advanced in good faith prior to the receipt of notice of cancellation by the foreclosure consultant or associate under the terms of the foreclosure consulting contract, together with interest at the prime rate published by the federal reserve plus two percentage points, with the total interest rate not to exceed eight percent per year, from the date of expenditure until repaid by the home owner.

(6) The right to cancel may not be conditioned on the repayment of any funds.

Source: L. 2006: Entire part added, p. 1336, § 1, effective May 30.

6-1-1106. Waiver of rights - void. (1) A provision in a foreclosure consulting contract is void as against public policy if the provision attempts or purports to:

(a) Waive any of the rights specified in this subpart 2 or the right to a jury trial;

(b) Consent to jurisdiction for litigation or choice of law in a state other than Colorado;

(c) Consent to venue in a county other than the county in which the property is located; or

(d) Impose any costs or fees greater than the actual costs and fees.

Source: L. 2006: Entire part added, p. 1337, § 1, effective May 30.

6-1-1107. Prohibited acts. (1) A foreclosure consultant may not:

(a) Claim, demand, charge, collect, or receive any compensation until after the foreclosure consultant has fully performed each and every service the foreclosure consultant contracted to perform or represented that the foreclosure consultant would perform;

(b) Claim, demand, charge, collect, or receive any interest or any other compensation for a loan that the foreclosure consultant makes to the home owner that exceeds the prime rate published by the federal reserve at the time of any loan plus two percentage points, with the total interest rate not to exceed eight percent per year;

(c) Take a wage assignment, lien of any type on real or personal property, or other security to secure the payment of compensation;

(d) Receive any consideration from a third party in connection with foreclosure consulting services provided to a home owner unless the consideration is first fully disclosed in writing to the home owner;

(e) Acquire an interest, directly, indirectly, or through an associate, in the real or personal property of a home owner with whom the foreclosure consultant has contracted;

(f) Obtain a power of attorney from a home owner for any purpose other than to inspect documents as provided by law; or

(g) Induce or attempt to induce a home owner to enter into a foreclosure consulting contract that does not comply in all respects with this subpart 2.

Source: L. 2006: Entire part added, p. 1337, § 1, effective May 30.

6-1-1108. Criminal penalties. A person who violates section 6-1-1107 is guilty of a misdemeanor, as defined in section 18-1.3-504, C.R.S., and shall be subject to imprisonment in county jail for up to one year, a fine of up to twenty-five thousand dollars, or both.

Source: L. 2006: Entire part added, p. 1338, § 1, effective May 30.

6-1-1109. Unconscionability. (1) A foreclosure consultant or associate may not facilitate or engage in any transaction that is unconscionable given the terms and circumstances of the transaction.

(2) (a) If a court, as a matter of law, finds a foreclosure consultant contract or any clause of such contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, enforce the remainder of the contract without the unconscionable clause, or so limit the application of any unconscionable clause as to avoid an unconscionable result.

(b) When it is claimed or appears to the court that a foreclosure consultant contract or any clause of such contract may be unconscionable, the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect, to aid the court in making the determination.

(c) In order to support a finding of unconscionability, there must be evidence of some bad faith overreaching on the part of the foreclosure consultant or associate such as that which results from an unreasonable inequality of bargaining power or other circumstances in which there is an absence of meaningful choice for one of the parties, together with contract terms that are, under standard industry practices, unreasonably favorable to the foreclosure consultant or associate.

Source: L. 2006: Entire part added, p. 1338, § 1, effective May 30.

6-1-1110. Language. A foreclosure consulting contract, and all notices of cancellation provided for therein, shall be written in English and shall be accompanied by a written translation from English into any other language principally spoken by the home owner, certified by the person making the translation as a true and correct translation of the English version. The translated version shall be presumed to have equal status and credibility as the English version.

Source: L. 2006: Entire part added, p. 1338, § 1, effective May 30.

SUBPART 3

EQUITY PURCHASERS

6-1-1111. Written contract required. Every contract shall be written in at least nine-point, legible type and fully completed, signed, and dated by the home owner and equity purchaser prior to the execution of any instrument quit-claiming, assigning, transferring, conveying, or encumbering an interest in the residence in foreclosure.

Source: L. 2006: Entire part added, p. 1338, § 1, effective May 30. **L. 2010:** Entire section amended, (HB 10-1133), ch. 350, p. 1616, § 4, effective January 1, 2011.

6-1-1112. Written contract - contents - notice. (1) Every contract shall contain the entire agreement of the parties and shall include the following terms:

(a) The name, business address, and telephone number of the equity purchaser;

(b) The street address and full legal description of the residence in foreclosure;

(c) Clear and conspicuous disclosure of any financial or legal obligations of the home owner that will be assumed by the equity purchaser. If the equity purchaser will not be assuming any financial or legal obligations of the home owner, the equity purchaser shall provide to the home owner a separate written disclosure that substantially complies with section 18-5-802 (6), C.R.S.

(d) The total consideration to be paid by the equity purchaser in connection with or incident to the acquisition by the equity purchaser of the residence in foreclosure;

(e) The terms of payment or other consideration, including, but not limited to, any services of any nature that the equity purchaser represents will be performed for the home owner before or after the sale;

(f) The date and time when possession of the residence in foreclosure is to be transferred to the equity purchaser;

(g) The terms of any rental agreement or lease;

(h) The specifications of any option or right to repurchase the residence in foreclosure, including the specific amounts of any escrow deposit, down payment, purchase price, closing costs, commissions, or other fees or costs;

(i) A notice of cancellation as provided in section 6-1-1114; and

(j) The following notice, in at least nine-point bold-faced type, and completed with the name of the equity purchaser, immediately above the statement required by section 6-1-1114:

NOTICE REQUIRED BY COLORADO LAW

Until your right to cancel this contract has ended, (Name) or anyone working for ______________ (Name) CANNOT ask you to sign or have you sign any deed or any other document.

(2) The contract required by this section survives delivery of any instrument of conveyance of the residence in foreclosure, but does not have any effect on persons other than the parties to the contract or affect title to the residence in foreclosure.

Source: L. 2006: Entire part added, p. 1339, § 1, effective May 30. **L. 2010:** IP(1)(j) amended, (HB 10-1133), ch. 350, p. 1617, § 5, effective January 1, 2011.

6-1-1113. Cancellation. (1) In addition to any right of rescission available under state or federal law, the home owner has the right to cancel a contract with an equity purchaser until 12 midnight of the third business day following the day on which the home owner signs a contract that complies with this part 11 or until 12 noon on the day before the foreclosure sale of the residence in foreclosure, whichever occurs first.

(2) Cancellation occurs when the home owner personally delivers written notice of cancellation to the address specified in the contract or upon deposit of such notice in the United States mail, properly addressed, with postage prepaid.

(3) A notice of cancellation given by the home owner need not take the particular form as provided with the contract and, however expressed, is effective if it indicates the intention of the home owner not to be bound by the contract.

(4) In the absence of any written notice of cancellation from the home owner, the execution by the home owner of a deed or other instrument of conveyance of an interest in the residence in foreclosure to the equity purchaser after the expiration of the rescission period creates a rebuttable presumption that the home owner did not cancel the contract with the equity purchaser.

Source: L. 2006: Entire part added, p. 1340, § 1, effective May 30.

6-1-1114. Notice of cancellation. (1) (a) The contract shall contain, as the last provision before the space reserved for the home owner's signature, a conspicuous statement in at least twelve-point bold-faced type, as follows:

> **You may cancel this contract for the sale of your house without any penalty or obligation at any time before ________________ (Date and time of day). See the attached notice of cancellation form for an explanation of this right.**

(b) The equity purchaser shall accurately specify the date and time of day on which the cancellation right ends.

(2) The contract shall be accompanied by duplicate completed forms, captioned "notice of cancellation" in at least nine-point bold-faced type if the contract is printed or in capital letters if the contract is typed, followed by a space in which the equity purchaser shall enter the date on which the home owner executed the contract. Such form shall:

(a) Be attached to the contract;

(b) Be easily detachable; and

(c) Contain the following statement, in at least nine-point type if the contract is printed or in capital letters if the contract is typed:

NOTICE OF CANCELLATION

> ________________ (Enter date contract signed). You may cancel this contract for the sale of your house, without any penalty or obligation, at any time before ________________ (Enter date and time of day). To cancel this transaction, personally deliver a signed and dated copy of this Notice of Cancellation in the United States mail, postage prepaid, to ________________________, (Name of purchaser) at ______________________________ (Street address of purchaser's place of business) NOT LATER THAN ________________ (Enter date and time of day). I hereby cancel this transaction ____________________ (Date) ________________________ (Seller's signature)

(3) The equity purchaser shall provide the home owner with a copy of the contract and the attached notice of cancellation.

(4) Until the equity purchaser has complied with this section, the home owner may cancel the contract.

Source: L. 2006: Entire part added, p. 1340, § 1, effective May 30. **L. 2010:** IP(2) and IP(2)(c) amended, (HB 10-1133), ch. 350, p. 1617, § 6, effective January 1, 2011.

6-1-1115. Options through reconveyances. (1) A transaction in which a home owner purports to grant a residence in foreclosure to an equity purchaser by an instrument that appears to be an absolute conveyance and reserves to the home owner or is given by the equity purchaser an option to repurchase shall be permitted only where all of the following conditions have been met:

(a) The reconveyance contract complies in all respects with section 6-1-1112;

(b) The reconveyance contract provides the home owner with a nonwaivable thirty-day right to cure any default of said reconveyance contract and specifies that the home owner may exercise this right to cure on at least three separate occasions during such reconveyance contract;

(c) The equity purchaser fully assumes or discharges the lien in foreclosure as well as any prior liens that will not be extinguished by such foreclosure, which assumption or discharge shall be accomplished without violation of the terms and conditions of the liens being assumed or discharged;

(d) The equity purchaser verifies and can demonstrate that the home owner has or will have a reasonable ability to make the lease payments and to repurchase the residence in foreclosure within the term of the option to repurchase under the reconveyance contract. For purposes of this section, there is a rebuttable presumption that the home owner has a reasonable ability to make lease payments and to repurchase the residence in foreclosure if

the home owner's payments for primary housing expenses and regular principal and interest payments on other personal debt do not exceed sixty percent of the home owner's monthly gross income; and

(e) The price the home owner must pay to exercise the option to repurchase the residence in foreclosure is not unconscionable. Without limitation on available claims under section 6-1-1119, a repurchase price exceeding twenty-five percent of the price at which the equity purchaser acquired the residence in foreclosure creates a rebuttable presumption that the reconveyance contract is unconscionable. The acquisition price paid by the equity purchaser may include any actual costs incurred by the equity purchaser in acquiring the residence in foreclosure.

Source: L. 2006: Entire part added, p. 1341, § 1, effective May 30.

6-1-1116. Waiver of rights - void. (1) A provision in a contract between an equity purchaser and home owner is void as against public policy if it attempts or purports to:

(a) Waive any of the rights specified in this subpart 3 or the right to a jury trial;

(b) Consent to jurisdiction for litigation or choice of law in a state other than Colorado;

(c) Consent to venue in a county other than the county in which the property is located; or

(d) Impose any costs or fees greater than the actual costs and fees.

Source: L. 2006: Entire part added, p. 1342, § 1, effective May 30.

6-1-1117. Prohibited conduct. (1) The contract provisions required by sections 6-1-1111 to 6-1-1114 shall be provided and completed in conformity with such sections by the equity purchaser.

(2) Until the time within which the home owner may cancel the transaction has fully elapsed, the equity purchaser shall not do any of the following:

(a) Accept from a home owner an execution of, or induce a home owner to execute, an instrument of conveyance of any interest in the residence in foreclosure;

(b) Record with the county recorder any document, including, but not limited to, the contract or any lease, lien, or instrument of conveyance, that has been signed by the home owner;

(c) Transfer or encumber or purport to transfer or encumber an interest in the residence in foreclosure to a third party; or

(d) Pay the home owner any consideration.

(3) Within ten days following receipt of a notice of cancellation given in accordance with sections 6-1-1113 and 6-1-1114, the equity purchaser shall return without condition the original contract and any other documents signed by the home owner.

(4) An equity purchaser shall make no untrue or misleading statements of material fact regarding the value of the residence in foreclosure, the amount of proceeds the home owner will receive after a foreclosure sale, any contract term, the home owner's rights or obligations incident to or arising out of the sale transaction, the nature of any document that the equity purchaser induces the home owner to sign, or any other untrue or misleading statement concerning the sale of the residence in foreclosure to the equity purchaser.

Source: L. 2006: Entire part added, p. 1342, § 1, effective May 30.

6-1-1118. Criminal penalties. A person who violates section 6-1-1117 (2) or (3) or who intentionally violates section 6-1-1117 (4) is guilty of a misdemeanor, as defined in section 18-1.3-504, C.R.S., and shall be subject to imprisonment in county jail for up to one year, a fine of up to twenty-five thousand dollars, or both.

Source: L. 2006: Entire part added, p. 1343, § 1, effective May 30.

6-1-1119. Unconscionability. (1) An equity purchaser or associate may not facilitate or engage in any transaction that is unconscionable given the terms and circumstances of the transaction.

(2) (a) If a court, as a matter of law, finds an equity purchaser contract or any clause of such contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, enforce the remainder of the contract without the unconscionable clause, or so limit the application of any unconscionable clause as to avoid an unconscionable result.

(b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable, the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect, to aid the court in making the determination.

(c) In order to support a finding of unconscionability, there must be evidence of some bad faith overreaching on the part of the equity purchaser or associate such as that which results from an unreasonable inequality of bargaining power or under other circumstances in which there is an absence of meaningful choice for one of the parties, together with contract terms that are, under standard industry practices, unreasonably favorable to the equity purchaser or associate.

Source: L. 2006: Entire part added, p. 1343, § 1, effective May 30.

6-1-1120. Language. (1) Any contract, rental agreement, lease, option or right to repurchase, and any notice, conveyance, lien, encumbrance, consent, or other document or instrument signed by a home owner, shall be written in English; except that, if the equity purchaser has actual or constructive knowledge that the home owner's principal language is other than English, the home owner shall be provided with a notice, written in the home owner's principal language, substantially as follows:

> **This transaction involves important and complex legal consequences, including your right to cancel this transaction within three business days following the date you sign this contract. You should consult with an attorney or seek assistance from a housing counselor by calling the Colorado foreclosure hotline at** ________________ [current, correct telephone number].

(2) If a notice in the home owner's principal language is required to be provided under subsection (1) of this section, the notice shall be given to the home owner as a separate document accompanying the written contract required by section 6-1-1111.

Source: L. 2006: Entire part added, p. 1343, § 1, effective May 30. **L. 2010:** Entire section amended, (HB 10-1133), ch. 350, p. 1617, § 7, effective January 1, 2011.

6-1-1121. Short sales - subsequent purchaser - definition. (1) With respect to any short sale transaction in which an equity purchaser intends to resell the residence in foreclosure to a subsequent purchaser, the equity purchaser shall:

(a) Provide full disclosure to the home owner and to the holders of the evidence of debt on the residence in foreclosure, or such holders' representatives, of the terms of the agreement between the equity purchaser and any subsequent purchaser, including but not limited to the purchase price to be paid by the subsequent purchaser for the residence in foreclosure, which disclosure shall be made within one business day of identifying any such subsequent purchaser and in no event later than closing on the short sale transaction;

(b) Provide full disclosure to any subsequent purchaser and to any subsequent purchaser's lender, or such lender's representative, at the time of contract with the equity purchaser, of the terms of the agreement between the equity purchaser and the home owner, including but not limited to the purchase price paid by the equity purchaser for the residence in foreclosure;

(c) Comply with all applicable rules adopted by the Colorado real estate commission with regard to short sales; and

(d) Comply with section 38-35-125, C.R.S.

(2) As used in this section, a "subsequent purchaser" means any person who enters into a contract with an equity purchaser prior to the disbursement of the short sale transaction to acquire the residence in foreclosure and who acquires the residence in foreclosure within fourteen days after the disbursement of the short sale transaction.

Source: L. 2010: Entire section added, (HB 10-1133), ch. 350, p. 1618, § 8, effective January 1, 2011.

ARTICLE 2

Unfair Practices Act

6-2-101. Short title. This article shall be known and may be cited as the "Unfair Practices Act".

Source: L. 37: p. 1287, § 14. **CSA:** C. 48, § 302(13). **L. 41:** p. 824, § 13. **L. 49:** p. 349, § 17. **CRS 53:** § 55-2-17. **C.R.S. 1963:** § 55-2-17.

ANNOTATION

Law reviews. For article, "The Unfair Practices Act of Colorado and Its Recent Amendment", see 26 Dicta 162 (1949). For article, "May Regulated Utilities Monopolize the Sun?", see 56 Den. L.J. 31 (1979). For article, "Utility Use of Renewable Resources: Legal and Economic Implications", see 59 U. Den. L.J. 663 (1982). For comment, "Antitrust Law in Colorado: Back on Track", see 60 Den. L.J. 645 (1983). For article, "Franchise Regulation", see 15 Colo. Law. 395 (1986). For note, "Permissible and Impermissible Vertical Restraints Under the Sherman Antitrust Act: Does 'Justice' Care?", see 63 Den. U. L. Rev. 127 (1986).

6-2-102. Legislative declaration. The general assembly declares that the purpose of this article is to safeguard the public against the creation or perpetuation of monopolies and to foster and encourage competition by prohibiting unfair and discriminatory practices by which fair and honest competition is destroyed or prevented. This article shall be liberally construed so that its beneficial purposes may be subserved.

Source: L. 41: p. 824, § 12. **CSA:** C. 48, § 302(12). **L. 49:** p. 349, § 16. **CRS 53:** § 55-2-16. **C.R.S. 1963:** § 55-2-16.

ANNOTATION

Law reviews. For article, "One Year Review of Constitutional and Administrative Law", see 34 Dicta 79 (1957). For article, "May Regulated Utilities Monopolize the Sun?", see 56 Den. L.J. 31 (1979).

The conclusion of the general assembly that predatory price wars are contrary to the interests of the public and that temporary public price advantages will ultimately lead to monopoly and prices uncontrolled by the forces of

competition is not so ill founded as to be contrary to the law or the constitution. Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

6-2-103. Discriminatory sales - exceptions. (1) It is unlawful for any person, firm, or corporation doing business in the state of Colorado and engaged in the production, manufacture, distribution, or sale of any commodity, product, or service of general use or consumption, or the sale of any merchandise or product by any public utility, with the intent to destroy the competition of any regular established dealer in such commodity, product, or service, or to prevent the competition of any person, firm, private corporation, or municipal or other public corporation that in good faith intends and attempts to become a dealer, to discriminate between different sections, communities, or cities, or portions thereof, or between different locations in such sections, communities, cities, or portions thereof in this state by selling or furnishing a commodity, product, or service at a lower rate in one section, community, or city, or any portion thereof, or in one location in such section, community, or city, or any portion thereof than in another after making allowance for the difference, if any, in the grade or quality, quantity, and actual cost of transportation from the point of production, if a raw product or commodity, or from the point of manufacture, if a manufactured product or commodity. Motion picture films when delivered under a lease to motion picture houses shall not be deemed to be a commodity or product of general use or consumption.

(2) Nothing in this article shall be construed to affect or apply to any service or product sold, rendered, or furnished by any public utility, the sale, rendition, or furnishing of which is subject to regulation by the Colorado public utilities commission or by any municipal regulatory body. This article shall not be construed to prohibit the meeting in good faith of a competitive rate.

(3) The inhibition in this section against locality discrimination shall embrace any scheme of special rebates, collateral contracts, or any device of any nature whereby such discrimination is, in substance or fact, effected in violation of the spirit and intent of this article.

(4) It is an unfair trade practice for any person, firm, or corporation doing business in this state and engaged in the production, manufacture, or distribution of either written or printed material or motion pictures to require a buyer or lessee, as a condition of the purchase or lease of such material or motion pictures, to accept other material or motion pictures which the buyer or lessee deems objectionable and written objection is made thereto by such buyer or lessee to the seller or lessor of said material or motion pictures within thirty days after delivery to said buyer or lessee. If such written objection is made within the time provided in this subsection (4), and the seller or lessor does not, within ten days of the receipt of said objection, repurchase or recall such objectionable material or motion pictures from the buyer or lessee, all the remedies provided in this article shall be applicable against said seller or lessor. The provisions of this subsection (4) shall apply whether the material or motion pictures are acquired by the buyer or lessee for resale, sublease, or for any other purpose.

Source: L. 37: p. 1280, § 1. **CSA:** C. 48, § 302(1). **L. 41:** p. 820, § 1. **L. 49:** p. 342, § 1. **CRS 53:** § 55-2-1. **C.R.S. 1963:** § 55-2-1. **L. 69:** p. 368, § 1. **L. 2007:** (1) amended, p. 513, § 1, effective April 16.

ANNOTATION

Law reviews. For article, "The Unfair Practices Act of Colorado and Its Recent Amendment", see 26 Dicta 162 (1949). For article, "One Year Review of Civil Procedure and Appeals", see 38 Dicta 133 (1961). For article, "One Year Review of Constitutional and Administrative Law", see 38 Dicta 154 (1961). For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967). For article, "May Regulated Utilities Monopolize the Sun?", see 56 Den. L.J. 31 (1979).

A "fair trade" price maintenance contract as described by this section is lawful. United States v. Frankfort Distilleries, 324 U.S. 293, 65 S. Ct. 661, 89 L. Ed. 649, rev'g 144 F.2d 824 (1945).

This section is not a price-fixing law. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1940).

Its purpose is to prevent ruinous price-cutting, by which the business of competitors might be injured and competition destroyed. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1940).

Consumers' payment of overcharges qualifies as a type of injury that the statute was designed to prevent. Dunlap v. Colo. Springs Cablevision, Inc., 829 P.2d 1286 (Colo. 1992).

Act applies whenever a business charges different prices to purchasers based on geographic differences with an intent to drive out competition in one geographic area. The act does not require that a business have more than one location. Dunlap v. Colo. Springs Cablevision, Inc., 855 P.2d 6 (Colo. App. 1992) (decided on remand from 829 P.2d 1286 (Colo. 1992)); Ervin v. Amoco Oil Co., 885 P.2d 246 (Colo. App. 1994), aff'd, 908 P.2d 493 (Colo. 1995).

A retailer, not guilty of any fraud or deception, who takes a smaller profit than another retailer is willing to accept for the same commodity is not engaged in unfair competition. Olin Mathieson Chem. Corp. v. Francis, 134 Colo. 160, 301 P.2d 139 (1956).

Actions performed for the purpose of injuring competitors or destroying competition are the only ones that violate this law, this purpose or intention is manifestly intended to be a vital element of the violation. Miller's Groceteria Co. v. Food Distribs. Ass'n, 107 Colo. 113, 109 P.2d 637 (1941).

Thus, where the evidence shows that defendants entered upon a carefully planned, intensive campaign, using nearly all of the common "tricks of the trade" to break into the market in the territory served by competitors, such constitutes a violation of this act. Old Homestead Bread Co. v. Marx Baking Co., 108 Colo. 375, 117 P.2d 1007 (1941).

Also, forcing such contracts is unlawful. Combinations of producers, wholesalers, and retailers, or any of them, to force others into making "fair trade" contracts are not lawful. United States v. Frankfort Distilleries, 324 U.S. 293, 65 S. Ct. 661, 89 L. Ed. 649, rev'g 144 F.2d 824 (1945).

Unfair practices act applicable to title insurance. The state's unfair practices act is applicable to the business of title insurance. Commander Leasing Co. v. Transamerica Title Ins. Co., 477 F.2d 77 (10th Cir. 1973).

This act is not analogous to federal Robinson-Patman Price Discrimination Act. Colorado's Unfair Practices Act does not cover discrimination between purchasers, but rather discrimination based upon and directed at geographic differences, termed "locality discrimination". Venta, Inc. v. Frontier Oil and Ref. Co., 827 F. Supp. 1526 (D. Colo. 1993).

Applied in Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975); Carlock v. Pillsbury Co., 719 F. Supp. 791 (D. Minn. 1989).

6-2-104. Personal responsibility. (1) Any person who, either as director, officer, or agent of any firm or corporation or as agent of any person violating the provisions of this article, assists or aids, directly or indirectly, in such violation shall be responsible equally with the person, firm, or corporation for which he acts.

(2) In the prosecution of any person as officer, director, or agent, it shall be sufficient to allege and prove the unlawful intent of the person, firm, or corporation for which he acts.

Source: L. 37: p. 1281, § 2. **CSA:** C. 48, § 302(2). **L. 41:** p. 821, § 2. **L. 49:** p. 343, § 2. **CRS 53:** § 55-2-2. **C.R.S. 1963:** § 55-2-2.

6-2-105. Unlawful to sell below cost. (1) (a) It is unlawful for any person, partnership, firm, corporation, joint stock company, or other association engaged in business within this state to sell, offer for sale, or advertise for sale any product or service for less than the cost of the product or service with the intent to both injure competitors and destroy competition and where the likely result of such sale would be the acquisition or maintenance of a monopoly. A vendor who violates this section is guilty of a misdemeanor and, upon conviction thereof, shall be subject to the penalties provided in section 6-2-116.

(b) (Deleted by amendment, L. 2007, p. 514, § 2, effective April 16, 2007.)

(2) For purposes of this section, "cost" means an appropriate determination of cost that is consistent with federal court interpretations of cost in federal predatory pricing cases under the federal "Sherman Act", 15 U.S.C. sec. 1 et seq.

(3) (Deleted by amendment, L. 2008, p. 2244, § 1, effective June 5, 2008.)

Source: L. 37: p. 1282, § 3. **CSA:** C. 48, § 302(3). **L. 41:** p. 821, § 3. **L. 49:** p. 343, § 3. **CRS 53:** § 55-2-3. **C.R.S. 1963:** § 55-2-3. **L. 93:** (1) amended, p. 1273, § 1,

effective July 1. **L. 2007:** (1) and (2) amended, p. 514, § 2, effective April 16. **L. 2008:** Entire section amended, p. 2244, § 1, effective June 5.

ANNOTATION

I. GENERAL CONSIDERATION.

Law reviews. For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967). For article, "May Regulated Utilities Monopolize the Sun?", see 56 Den. L.J. 31 (1979).

When consideration is paid for one product that is sold in conjunction with another product advertised to be "free" or otherwise offered at no cost to the consumer, the transaction constitutes a combined sale, and thus is not a gift pursuant to the unfair practices act. Defendant's offer of a free car wash in conjunction with the purchase of gasoline is not a gift pursuant to this section. Mastercar, Inc. v. Amoco Oil Co., 835 P. 2d 534 (Colo. App. 1992).

Applied in Val Vu, Inc. v. Lacey, 31 Colo. App. 55, 497 P.2d 723 (1972); Colo. Petroleum Marketers Ass'n v. Southland Corp., 476 F. Supp. 373 (D. Colo. 1979).

II. UNLAWFUL TO SELL BELOW COST.

Where a merchant is charged with selling goods at below cost in violation of the unfair practices act, it is not error for the trial court to permit evidence to prove the actual intent animating the admitted sales below cost. Perkins v. King Soopers, Inc., 122 Colo. 263, 221 P.2d 343 (1950).

A statute attempting to prohibit all sales below cost would be unconstitutional. Olin Mathieson Chem. Corp. v. Francis, 134 Colo. 160, 301 P.2d 139 (1956).

To avoid this result, only such sales may be prohibited which are intended to injure the public in a manner warranting the exercise of the police power. Olin Mathieson Chem. Corp. v. Francis, 134 Colo. 160, 301 P.2d 139 (1956).

Thus, intent has to be proved, otherwise this section would be a flat fixing of prices without regard to the public welfare. Olin Mathieson Chem. Corp. v. Francis, 134 Colo. 160, 301 P.2d 139 (1956).

Moreover, in action for violation of this section where company denied allegation that the advertisement of intent to give away and the giving away of samples was done for the purpose of injuring competitors or destroying competition, an issue of fact was tendered which could not be disposed of by a motion for judgment on the pleadings. Miller's Groceteria Co. v. Food Distribs. Ass'n, 107 Colo. 113, 109 P.2d 637 (1941).

Where the ability to make a purchase at a concession price is expressly contingent on the purchase of other goods, the concession goods are sold below cost only if the total price paid by the customer for the goods involved in such linked transactions is below the total cost of such goods. Parish Oil Co. v. Dillon Cos., 523 F.3d 1244 (10th Cir. 2008) (decided under law in effect prior to 2007 amendment).

A grocery store may sell gasoline below cost if such sales are conditioned on the purchase of enough groceries above cost that the entire series of transactions comes in at a profit. Parish Oil Co. v. Dillon Cos., 523 F.3d 1244 (10th Cir. 2008) (decided under law in effect prior to 2007 amendment).

III. COST.

Evidence which seeks to establish "cost" and "cost of doing business" need not be sufficient to establish these facts with mathematical precision and exactness, the proof need not exist to that high degree of certainty. Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

Such is a problem of sufficiency, not constitutionality. Establishing by competent and material evidence allegations with respect to definitions of costs as applied to "production" and relative to "cost of doing business" or "overhead expense" is not a problem of constitutionality, but a problem of sufficiency of the evidence. Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

Difficulty in application not enough to render section unconstitutional. Any difficulty in computing cost is a factual one, and this section is not to be declared invalid because in its application factual difficulties may arise; mere difficulty of application in the processes of litigation is not enough to enable a court to say that a statute is unconstitutional. Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

Moreover, the term "cost" or "cost of doing business" is not so vague and indefinite that it violates the substantive due process requirement of the fourteenth amendment to the federal constitution or is so vague that it is wholly impractical. Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

"Seller's costs" means the expense to seller to provide an article or product to its users. Pepcol Mfg. Co. v. Denver Union Corp., 668 P.2d 971 (Colo. App. 1983).

IV. COST OF DOING BUSINESS.

The "cost of doing business" which must be added to the invoice cost need not be absolutely exact or based upon a precise method of accounting which any one merchant might adopt. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1940); Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

Rather, the term means the approximate cost arrived at by a reasonable rule. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1940); Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

Hence, if a particular method adopted by a merchant cannot be said to be unreasonable, and does not disclose an intentional evasion of the law, the method so adopted should be accepted as correct. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1940); Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

In other words, all that a man is required to do under the statute is to act in good faith. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1940); Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

6-2-106. How cost established. In establishing the cost of a given product to the distributor and vendor, the invoice cost of the product purchased at a forced, bankrupt, closeout sale, or other sale outside of the ordinary channels of trade may not be used as a basis for justifying a price lower than one based upon the replacement cost as of date of said sale of the product replaced through the ordinary channels of trade, unless the product is kept separate from goods purchased in the ordinary channels of trade and unless the product is advertised and sold as merchandise purchased at a forced, bankrupt, closeout sale, or by means other than through the ordinary channels of trade. The advertising shall state the conditions under which said goods were purchased and the quantity of such merchandise to be sold or offered for sale.

Source: L. 37: p. 1283, § 4. **CSA:** C. 48, § 302(4). **L. 41:** p. 822, § 4. **L. 49:** p. 344, § 4. **CRS 53:** § 55-2-4. **C.R.S. 1963:** § 55-2-4. **L. 2007:** Entire section amended, p. 514, § 3, effective April 16.

6-2-107. Allegation and proof - evidence. In any injunction proceeding or in the prosecution of any person as officer, director, or agent, it shall be sufficient to allege and prove the unlawful intent of the person, firm, or corporation for which he acts. Where a particular trade or industry of which the person, firm, or corporation complained against is a member has an established cost survey for the locality and vicinity in which the offense is committed, the cost survey shall be deemed competent evidence to be used in proving the costs of the person, firm, or corporation complained against within the provisions of this article.

Source: L. 37: p. 1283, § 5. **CSA:** C. 48, § 302(5). **L. 41:** p. 822, § 5. **L. 49:** p. 344, § 5. **CRS 53:** § 55-2-5. **C.R.S. 1963:** § 55-2-5.

ANNOTATION

Evidence of intent sufficient for injunction. Defendant's refusal to attend meetings for the purpose of reaching an agreement on the cost of doing business and asserting that he did not think the law could be enforced indicated an intent not to obey it; this, and other, evidence was sufficient to warrant injunction against violation of law. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1940).

6-2-108. Secret rebates or refunds prohibited. The secret payment or allowance of rebates, refunds, commissions, or unearned discounts, whether in the form of money or otherwise, or secretly extending to certain purchasers special services or privileges not extended to all purchasers upon like terms and conditions, to the injury of a competitor and

where such payment or allowance tends to destroy competition, is an unfair trade practice. Any person, firm, partnership, corporation, or association resorting to such unfair trade practice is guilty of a misdemeanor and, upon conviction thereof, shall be subject to the penalties provided in section 6-2-116.

Source: L. 37: p. 1284, § 7. **CSA:** C. 48, § 302(7). **L. 41:** p. 823, § 7. **L. 49:** p. 345, § 7. **CRS 53:** § 55-2-7. **C.R.S. 1963:** § 55-2-7.

ANNOTATION

Law reviews. For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967).

Section 6-2-109 inapplicable. Since the reference in § 6-2-109 is "to" § 6-2-108, that section is excluded and § 6-2-109 is inapplicable to secret rebates or refunds. Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975).

6-2-109. Contract illegal - when. Any contract, express or implied, made by any person, firm, or corporation in violation of any of the provisions of sections 6-2-103 to 6-2-108 is an illegal contract, and no recovery thereon shall be had; except that no part of this article shall prevent the payment of patronage refunds by cooperative agencies or associations existing and operating under the laws of this state.

Source: L. 37: p. 1285, § 9. **CSA:** C. 48, § 302(8). **L. 41:** p. 823, § 8. **L. 49:** p. 345, § 8. **CRS 53:** § 55-2-8. **C.R.S. 1963:** § 55-2-8.

ANNOTATION

Law reviews. For article, "An Introduction to the Economic Analyses of Contract Remedies", see 57 U. Colo. L. Rev. 683 (1986).

Section 6-2-108 excluded. Since the reference in § 6-2-109 is "to" § 6-2-108, that section is excluded and § 6-2-109 is inapplicable to secret rebates or refunds. Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975).

6-2-110. When provisions not applicable. (1) The provisions of sections 6-2-105 to 6-2-107 shall not apply to any sale made:

(a) In closing out in good faith the owner's stock or any part thereof for the purpose of discontinuing his trade in any such stock or commodity, and in the case of the sale of seasonal goods or the bona fide sale of perishable goods to prevent loss to the vendor by spoilage or depreciation, if notice is given to the public thereof;

(b) When the goods are damaged or deteriorated in quality and notice is given to the public thereof;

(c) By an officer acting under the orders of any court;

(d) In an endeavor made in good faith to meet the prices of a competitor selling the same product or service in the same locality or trade area.

(2) Any person, firm, or corporation who performs work upon, renovates, alters, or improves any personal property belonging to another person, firm, or corporation shall be construed to be a vendor within the meaning of this article.

Source: L. 37: p. 1283, § 6. **CSA:** C. 48, § 302(6). **L. 41:** p. 822, § 6. **L. 49:** p. 344, § 6. **CRS 53:** § 55-2-6. **C.R.S. 1963:** § 55-2-6. **L. 2007:** (1)(d) amended, p. 514, § 4, effective April 16.

ANNOTATION

Law reviews. For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967).

The term "trade area" as used in this section is not limited in terms of the immediate geographic area of the business. Val Vu, Inc. v. Lacey, 31 Colo. App. 55, 497 P.2d 723 (1972).

So where there are a significant number of persons who would leave a particular mer-

chant's immediate area and go to an adjoining area as a result of advertisement from that area's newspapers, that merchant should be allowed to meet those advertised prices without violating this statute. Val Vu, Inc. v. Lacey, 31 Colo. App. 55, 497 P.2d 723 (1972).

For example, Boulder merchant may meet Denver prices. In the light of the mobility of our population, and the proclivity of residents of Boulder to shop throughout the Denver metropolitan area, a Boulder merchant may meet Denver prices. Val Vu, Inc. v. Lacey, 31 Colo. App. 55, 497 P.2d 723 (1972).

6-2-111. Unlawful acts - remedy - license. (1) Any person, firm, private corporation, municipal corporation, public corporation, or trade association may maintain an action to enjoin a continuance of any act in violation of sections 6-2-103 to 6-2-108 or section 6-2-110 and, if injured thereby, for the recovery of damages. If, in such action, the court finds that the defendant is violating or has violated any of the provisions of sections 6-2-103 to 6-2-108 or section 6-2-110, it shall enjoin the defendant from a continuance of the violations. It shall not be necessary that actual damages to the plaintiff be alleged or proved. In addition to such injunctive relief, the plaintiff in said action shall be entitled to recover from the defendant three times the amount of the actual damages, if any, sustained.

(2) Without prejudice to the rights of any person, firm, private corporation, municipal corporation, public corporation, or trade association to bring an action, the attorney general of the state of Colorado, as an incident to and power of his office, has like powers to those provided in subsection (1) of this section, and it is his duty, upon showing by any person, firm, private corporation, municipal corporation, public corporation, or trade association that there is reason to believe that any person subject to the terms of this article is violating any term of sections 6-2-103 to 6-2-108 or section 6-2-110, to prosecute actions for violation of any provisions of this article, and to seek injunctions or restraining orders to enjoin the continuance thereof by any defendant.

(3) If any person, firm, private corporation, municipal corporation, public corporation, or trade association, in writing and under oath, submits to the attorney general a statement setting forth facts sufficient to constitute a prima facie case of violation of any of the provisions of sections 6-2-103 to 6-2-108 or any other provisions of this article, it shall be mandatory upon the attorney general to seek injunctive relief or restraining orders to enjoin the continuance of such violation by any person, firm, private corporation, or other organization so charged; and to this end, and for this purpose, the attorney general has the power to appear in his official capacity in any court in the state of Colorado, having jurisdiction in the premises, to seek relief.

(4) It is the duty of any district attorney in and for each of the judicial districts of the state of Colorado, when requested in writing by the attorney general, to advise and consult with the attorney general concerning the institution and prosecution of such actions, and to act for the attorney general in prosecution of any such action; but the attorney general has the power in his discretion to choose, select, appoint, and recompense from funds provided for the purposes of enforcement of the provisions of this article any attorney-at-law admitted to practice in the state of Colorado as a special prosecutor who has full and complete power to act for the attorney general.

(5) The attorney general, for the purposes of carrying out the terms and provisions of this article, has the power to promulgate rules and regulations for the enforcement of this article, not inconsistent with its terms, and to publish the same.

(6) The attorney general is empowered to appoint such personnel as may reasonably be required to carry out the functions prescribed for his office.

Source: L. 37: p. 1285, § 10. **CSA:** C. 48, § 302(9). **L. 41:** p. 823, § 9. **L. 49:** p. 345, § 9. **CRS 53:** § 55-2-9. **C.R.S. 1963:** § 55-2-9. **L. 69:** p. 369, § 1.

ANNOTATION

Law reviews. For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967).

Unfair Practices Act does not require that a plaintiff make a prima facie showing to sup-

port the allegations of a complaint before obtaining discovery. Direct Sales Tire Co. v. Dist. Court, 686 P.2d 1316 (Colo. 1984).

Enforcement of unfair practices act is left to the courts instead of to an administrative board. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1940).

Where an injunction is sought, this section is viewed from the standpoint not of the prudent man, but rather from the standpoint of the judge hearing the case; therefore, the proper test is whether the standards contained in the statutory provisions are so vague as to make it impossible to adjudicate rights arising out of their provisions. Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

In an injunction action, prospective in effect, the terms "cost" and "cost of doing business" are not so indefinite and uncertain as to provide no basis for the adjudication of rights. Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

Furthermore, the adjudication itself provides notice to defendant. When a plaintiff seeks an injunction he is not demanding that the defendant be punished, but rather that he be restrained from acting unlawfully in the future. Consequently, the adjudication itself provides notice to the defendant and is prospective in its application, and the result is that the defendant is not prejudiced by the failure of the statute to provide precise and adequate warning beforehand. Where, however, the requested sanction is penal or criminal, there is a reasonable basis for requiring it to give actual prior notice so that men of common intelligence are not required to guess at its meaning and differ as to its application. Flank Oil Co. v. Tennessee Gas Transmission Co., 141 Colo. 554, 349 P.2d 1005 (1960).

This section does not contravene § 16 of art. II, Colo. Const., which guarantees trial by jury in criminal cases, since the effect of injunctive relief in a civil action is different from that following a judgment under a criminal information. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1940).

A nonprofit corporation is a proper party plaintiff for the maintenance of a suit under this section, whether it be classed as a private corporation or an association. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1940).

A nonprofit corporation is entitled to the same protection against unfair competition as a for-profit corporation and has standing to bring an action for a preliminary injunction against alleged unfair competition. Am. Ski Ass'n v. Bergstedt, 682 P.2d 57 (Colo. App. 1984).

When there is sufficient evidence to sustain a ruling or judgment under this section, the same will not be disturbed on appeal. Dikeou v. Food Distribs. Ass'n, 107 Colo. 38, 108 P.2d 529 (1941).

For an injunction held not too broad, see Old Homestead Bread Co. v. Marx Baking Co., 108 Colo. 375, 117 P.2d 1007 (1941).

An injunction properly entered against two companies. Where two companies had the same officers and directors, the sales manager acted as such for both companies, the products were identical and it was these products that were made the instruments of an offense under this act, an injunction restraining violations was properly entered as against both companies. Old Homestead Bread Co. v. Marx Baking Co., 108 Colo. 375, 117 P.2d 1007 (1941).

If the practice sought to be restrained in an injunction suit has been abandoned in good faith and for all time, a decree enjoining the practice is without prejudice to defendant, while it affords protection to which the plaintiff is entitled. Old Homestead Bread Co. v. Marx Baking Co., 108 Colo. 375, 117 P.2d 1007 (1941).

Consumers may maintain an action for damages if they can show that they have been injured as a result of an antitrust violation specified in this section, and the injury is the type of injury that the particular antitrust statutory provision was designed to prevent. Dunlap v. Colo. Springs Cablevision, Inc., 829 P.2d 1286 (Colo. 1992).

6-2-111.5. Civil discovery requests. (1) When the attorney general has reasonable cause to believe that any person, partnership, firm, corporation, joint stock company, or other association has engaged in or is engaging in a violation of any provision of this article, the attorney general may:

(a) Request such person to file a statement or report in writing, under oath or otherwise, on forms prescribed by the attorney general, or to answer in writing, under oath or otherwise, any questions propounded by the attorney general as to all facts and circumstances reasonably related to the alleged violation, and to provide any other data and information the attorney general reasonably deems to be necessary;

(b) Issue subpoenas to require the attendance of witnesses or the production of relevant documents, administer oaths, conduct hearings in aid of an investigation or inquiry, and prescribe such forms and promulgate such rules as may reasonably be deemed to be necessary to administer the provisions of this article; and

(c) Make true copies, at the expense of the attorney general, of any documents

examined pursuant to paragraph (b) of this subsection (1), which copies may be offered into evidence in lieu of the originals thereof in any civil action brought pursuant to this article. The person producing the documents may require that the attorney general make copies of the documents. If the attorney general determines the use of originals is necessary, the attorney general shall pay to have copies of those documents made for use by the person producing the documents.

(2) Service of any request or subpoena shall be made in the manner prescribed by law.

(3) Any written response, testimony, or documents obtained by the attorney general pursuant to this section or any information derived directly or indirectly from such written response, testimony, or documents shall not be admissible in evidence in any criminal prosecution against the person providing the written response, testimony, or documents. The provisions of this subsection (3) shall not be construed to prevent any law enforcement officer having an independent basis therefor from producing or obtaining the same or similar facts, information, or evidence for use in any criminal prosecution.

(4) Nothing in this section shall prohibit the attorney general from disclosing information obtained pursuant to this section to any other law enforcement agency or department of any governmental or public entity of this or any other state or to the federal government if such other law enforcement agency or department executes an agreement that such information will remain confidential and will not be used in any criminal prosecution against the person providing the written response, testimony, or documents.

(5) If any person fails to appear or fails to cooperate with any investigation or inquiry pursuant to a request or subpoena issued pursuant to this section, the attorney general may apply to any district court for an appropriate order to effect the purposes of this section. The application shall state that there is reasonable cause to believe that the order applied for is necessary to investigate, prosecute, or terminate a violation of this article. If the court is satisfied that reasonable cause exists, the court may:

(a) Require the attendance of or the production of documents by such person, or both;

(b) Assess a civil penalty of up to five thousand dollars for such failure to appear and answer questions, written or otherwise, or such failure to produce documents unless the court finds that the failure to appear, to answer questions, or to produce documents was substantially justified or that other circumstances make an assessment of a civil penalty unjust;

(c) Award the attorney general reasonable costs and attorney fees in making this application unless the court finds that the failure to appear, to answer questions, or to produce documents was substantially justified or that other circumstances make an award of costs and attorney fees unjust;

(d) Enter any protective order as provided for in the Colorado rules of civil procedure;

(e) Grant such other or further relief as may be necessary to obtain compliance by such person.

Source: L. 93: Entire section added, p. 1273, § 2, effective July 1.

6-2-112. Testimony - books and records. In an action brought under this article, any defendant may be required to testify under subpoena duly issued in pursuance to the Colorado rules of civil procedure, and the books and records of any such defendant may be brought into court and introduced into evidence. No information so obtained may be used against the defendant as a basis for a misdemeanor prosecution under the provisions of this article.

Source: L. 49: p. 347, § 10. **CSA:** C. 48, § 302(9a). **CRS 53:** § 55-2-10. **C.R.S. 1963:** § 55-2-10.

6-2-113. Selling below cost. For the purposes of this article, in all sales involving more than one product or service and in all sales involving the giving of any concession of any kind, the combined total selling price of all products or services shall be compared to the

combined total cost of all products or services involved in the sales to determine whether the vendor or distributor is selling below cost.

Source: L. 49: p. 347, § 11. **CSA:** C. 48, § 302(9b). **CRS 53:** § 55-2-11. **C.R.S. 1963:** § 55-2-11. **L. 2007:** Entire section amended, p. 514, § 5, effective April 16.

ANNOTATION

Where the ability to make a purchase at a concession price is expressly contingent on the purchase of other goods, the concession goods are sold below cost only if the total price paid by the customer for the goods involved in such linked transactions is below the total cost of such goods. Parish Oil Co. v. Dillon Cos., 523 F.3d 1244 (10th Cir. 2008) (decided under law in effect prior to 2007 amendment).

A grocery store may sell gasoline below cost if such sales are conditioned on the purchase of enough groceries above cost that the entire series of transactions comes in at a profit. Parish Oil Co. v. Dillon Cos., 523 F.3d 1244 (10th Cir. 2008) (decided under law in effect prior to 2007 amendment).

6-2-114. Advertising goods not available. It is unlawful for any person, firm, or corporation engaged in business within the state of Colorado to advertise goods, wares, or merchandise which they are not prepared and able to supply to the consuming public in pursuance of such advertisement.

Source: L. 49: p. 347, § 12. **CSA:** C. 48, § 309(9c). **CRS 53:** § 55-2-12. **C.R.S. 1963:** § 55-2-12.

6-2-115. Evidence to establish legal price. (Repealed)

Source: L. 49: p. 348, § 13. **CSA:** C. 48, § 302(9d). **CRS 53:** § 55-2-13. **C.R.S. 1963:** § 55-2-13. **L. 2007:** Entire section repealed, p. 515, § 6, effective April 16.

6-2-115.5. State agencies - authority to contract with private enterprise. (1) Any state agency which is provided goods or services or which provides goods to the public, including manufacturing, processing, selling, offering for sale, renting, leasing, delivering, distributing, or advertising, shall determine if such goods can also be provided for by contract with private persons, partnerships, or corporations or any other type of private enterprise.

(2) Whenever a state agency determines that goods provided by it to the public can be more cost-effectively delivered by contract with private enterprise, or whenever a state agency determines that goods can be provided to it more cost-effectively by contract with private enterprise, such state agency is authorized to enter into a contract, in accordance with the "Procurement Code", articles 101 to 112 of title 24, C.R.S., to obtain such goods.

(3) The provisions of subsections (1) and (2) of this section do not apply to the division of correctional industries products and services as long as such products and services are of comparable price and quality.

Source: L. 83: Entire section added, p. 395, § 1, effective June 3.

Cross references: For the requirements concerning purchasing by state agencies of correctional industries goods and services, see article 24 of title 17.

6-2-116. Penalty. Any person, firm, or corporation, whether as principal, agent, officer, or director, for himself or itself, or for another person, or for any firm or corporation who violates any of the provisions of sections 6-2-103 to 6-2-108 or section 6-2-110, is guilty of a misdemeanor for each single violation and, upon conviction thereof, shall be punished by a fine of not less than one hundred dollars nor more than one thousand dollars, or by imprisonment for not more than six months, or by both such fine and imprisonment.

Source: L. 37: p. 1286, § 11. **CSA:** C. 48, § 302(10). **L. 41:** p. 824, § 10. **L. 49:** p. 349, § 14. **CRS 53:** § 55-2-14. **C.R.S. 1963:** § 55-2-14.

ANNOTATION

Law reviews. For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967).

6-2-117. Remedies cumulative. The remedies prescribed in this article are cumulative.

Source: L. 41: p. 824, § 11. **CSA:** C. 48, § 302(11). **L. 49:** p. 349, § 15. **CRS 53:** § 55-2-15. **C.R.S. 1963:** § 55-2-15.

ARTICLE 2.5

Colorado Junk Email Law

6-2.5-101 to 6-2.5-105. (Repealed)

Source: L. 2008: Entire article repealed, p. 596, § 3, effective August 5.

Editor's note: This article was added in 2000 and was not amended prior to its repeal in 2008. For the text of this article prior to 2008, consult the 2007 Colorado Revised Statutes.

ARTICLE 2.7

Internet Evidence for Law Enforcement Investigations

6-2.7-101. Definitions. As used in this article, unless the context otherwise requires:

(1) "Court order" means an order for the release of information, including but not limited to a subpoena, court order, search warrant, or summons.

(2) "Internet access provider" means an entity that provides electronic communications or remote computing as defined in 18 U.S.C. sec. 119 and sec. 121, to customers in Colorado. "Internet access provider" shall not include noninternet-based communications.

Source: L. 2006: Entire article added, p. 2057, § 9, effective October 1.

6-2.7-102. Internet evidence for law enforcement - preserve and release evidence - reports - training materials. (1) (a) An internet access provider, upon the request of a law enforcement agency, shall take all necessary steps to preserve records and other evidence in its possession pending the issuance of a court order or other legal process. The internet access provider shall comply with the request as soon as possible following receipt.

(b) Records referred to in paragraph (a) of this subsection (1) shall be retained for a period of ninety days, which shall be extended for an additional ninety-day period upon a renewed request by the law enforcement agency.

(2) (a) An internet access provider shall release evidence regarding all categories of information identified in 18 U.S.C. sec. 2703 (c) (2) that are in its possession within ten days after receiving a court order requiring the internet access provider to release such evidence to law enforcement. If the internet access provider demonstrates to the requesting law enforcement agency within five days of the request that, for bona fide technical reasons,

it cannot comply with the order within ten days of the request, it shall make every reasonable effort to comply with the request as soon as reasonably possible.

(b) In connection with any criminal investigation regarding possible sex offenses involving a child under section 18-1.3-1003, C.R.S., that involves immediate danger of death or serious bodily harm, a law enforcement agency in this state may issue a request, without compulsory legal process or court order, to a designated recipient of the internet access provider to disclose, consistent with 18 U.S.C. sec. 2702 (c) (4), the information identified in paragraph (a) of this subsection (2). The internet access provider shall comply with the request immediately and without delay, or if unable to immediately comply, communicate with the requesting agency to discuss the nature of the request and to coordinate a timely response.

(3) An internet access provider doing business in this state shall report incidents of apparent child pornography to the national center for missing and exploited children pursuant to 42 U.S.C. sec. 13032. The report shall include, if available, the subscriber's city and state or zip code.

(4) Each internet access provider with more than fifteen thousand subscribers who are residents of this state shall, upon request of the attorney general, provide training materials to law enforcement agencies in this state regarding best practices for investigating internet-related crimes involving sexual exploitation of children, the internet access provider's law enforcement compliance practices, and contact information for the internet access provider and its designated recipient for law enforcement requests.

(5) Subsections (1) and (2) of this section shall be interpreted consistent with the requirements of federal law that apply to internet access providers, including but not limited to 18 U.S.C. 2701 et seq. and 42 U.S.C. 13032.

Source: L. 2006: Entire article added, p. 2058, § 9, effective October 1.

6-2.7-103. Internet evidence - failure to release or preserve - civil penalty. (1) An internet access provider that fails to comply with the requirements in section 6-2.7-102 (1) or (2) shall be liable for payment of a civil penalty of up to two thousand five hundred dollars for each incidence of noncompliance; except that the internet access provider shall be liable for payment of up to ten thousand dollars for a third and subsequent incidence of noncompliance that occurs within a twelve-month period. The state attorney general is authorized to bring suit in a court of competent jurisdiction for enforcement of the provisions of this subsection (1).

(2) Except as otherwise provided in subsection (1) of this section, an internet access provider's failure to comply with the requirements specified in section 6-2.7-102 shall not result in further civil liability to the state.

Source: L. 2006: Entire article added, p. 2059, § 9, effective October 1.

ARTICLE 3

Fair Trade Act

6-3-101 to 6-3-106. (Repealed)

Source: L. 75: Entire article repealed, p. 261, § 1, effective July 1.

Editor's note: This article was numbered as article 1 of chapter 55, C.R.S. 1963. For amendments to this article prior to its repeal in 1975, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

ARTICLE 4

Colorado Antitrust Act of 1992

Editor's note: This article was numbered as article 4 of chapter 55, C.R.S. 1963. The substantive provisions of this article were repealed and reenacted in 1992, resulting in the addition, relocation, and

elimination of sections as well as subject matter. For amendments to this article prior to 1992, consult the Colorado statutory research explanatory note beginning on page vii in the front of this volume. Former C.R.S. section numbers are shown in editor's notes following those sections that were relocated.

Law reviews: For article, "The 1992 Colorado Antitrust Act: Per Se Bidrigging and Key Issues", see 22 Colo. Law. 2229 (1993); for article, "The Colorado Antitrust Act of 1992", see 22 Colo. Law. 695 (1993); for article, "Antitrust Questions and Answers: A Primer for Practitioners", see 24 Colo. Law. 521 (1995).

6-4-101. Short title. This article shall be known and may be cited as the "Colorado Antitrust Act of 1992".

Source: L. 92: Entire article R&RE, p. 236, § 1, effective July 1.

6-4-102. Legislative declaration. The general assembly hereby finds and determines that competition is fundamental to the free market system and that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality commodities and services, and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic, political, and social institutions.

Source: L. 92: Entire article R&RE, p. 236, § 1, effective July 1.

6-4-103. Definitions. (1) "Commodity" includes, but is not limited to, any goods, merchandise, wares, produce, chose in action, land, articles of commerce, or any other tangible or intangible property, real, personal, or mixed, for use, consumption, production, enjoyment, or resale.

(2) "Governmental or public entity" means the state and any of its departments, boards, agencies, instrumentalities, authorities, and commissions and any political subdivisions, including but not limited to counties, city and counties, municipalities, school districts, local improvement districts, law enforcement authorities, water, sanitation, fire protection, metropolitan, irrigation, drainage, or other special districts, and any other municipal, quasi-municipal, or public corporation organized pursuant to the constitution or other law, and any of the political subdivision's respective departments, boards, agencies, instrumentalities, authorities, and commissions.

(3) "Person" includes any natural person, any firm, association, organization, business or other trust, company, corporation, joint venture, partnership, proprietorship, or other business entity, whether or not for profit, and any governmental or public entity.

(4) "Service" includes, but is not limited to, any kind of activity performed in whole or in part for economic or noneconomic benefit.

(5) "Trade or commerce" means any and all economic activity carried on wholly or partially in this state which involves or relates to any commodity or service.

Source: L. 92: Entire article R&RE, p. 236, § 1, effective July 1.

6-4-104. Illegal restraint of trade or commerce. Every contract, combination in the form of a trust or otherwise, or conspiracy in restraint of trade or commerce is illegal.

Source: L. 92: Entire article R&RE, p. 237, § 1, effective July 1.

Editor's note: This section is similar to former § 6-4-101, as it existed prior to 1992.

ANNOTATION

Law reviews. For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967). For comment, "Colorado Antitrust Law: Untied and Drifting", see 48 U. Colo. L. Rev. 215 (1977). For article, "Antitrust Enforcement in Colorado: New Directions, New Concerns", see 6 Colo. Law 1 (1977). For article, "May Regulated Utilities Monopolize the Sun?", see 56 Den. L.J. 31 (1979). For comment, "Antitrust Law in Colorado: Back on Track", see 60 Den. L.J. 645 (1983). For article, "Antitrust Law", which discusses recent Tenth Circuit decisions dealing with antitrust law, see 61 Den. L.J. 135 (1984). For article, "Colorado Antitrust Law Seven Years Later", see 13 Colo. Law. 1808 (1984). For article, "Antitrust Law", which discusses recent Tenth Circuit decisions dealing with antitrust law, see 62 Den. U. L. Rev. 25 (1985). For article, "Franchise Regulation", see 15 Colo. Law. 395 (1986). For article, "Does a Monopolist Have a Duty to Deal With Its Rivals? Some Thoughts On the Aspen Skiing Case", see 57 U. Colo. L. Rev. 727 (1986). For article, "Antitrust Law", which discusses recent Tenth Circuit decisions dealing with antitrust law, see 62 Den. U.L. Rev. 183 (1986). For article, "Antitrust Law", which discusses recent Tenth Circuit decisions dealing with antitrust law, see 64 Den. U.L. Rev. 131 (1987). For article, "United States Supreme Court Review of Tenth Circuit Decisions", which discusses the Aspen Skiing Co. case, see 64 Den. U.L. Rev. 373 (1987). For article, "Antitrust Law", which discusses recent Tenth Circuit decisions dealing with antitrust law, see 65 Den. U. L. Rev. 389 (1988). For note, "Developments in Antitrust Law", see 66 Den. U. L. Rev. 659 (1989). For a discussion of a recent Tenth Circuit decision dealing with antitrust law, see 66 Den. U. L. Rev. 813 (1989). For article, "Antitrust in the Health Care Field — Subject Matter Jurisdiction", see 18 Colo. Law. 1113 (1989). For discussions of recent Tenth Circuit decisions dealing with questions of antitrust law, see 67 Den. U. L. Rev. 619(1990). For article, "Anti-trust Developments: U.S. Supreme Court Cases — 1989-1990 Term", see 20 Colo. Law. 1 (1991).

Annotator's note. Since § 6-4-104 is similar to § 6-4-101 as it existed prior to the 1992 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

Purpose of state antitrust legislation. State antitrust legislation serves the important function of protecting the public against illegal trade restraints beyond the reach of federal law, without undercutting the legitimate rights of employees to engage in lawful, concerted activities for the purpose of improving their wages, hours and other conditions of employment. People v. North Ave. Furn. & Appliance, Inc., 645 P.2d 1291 (Colo. 1982).

Antitrust statute, as does its federal counterpart, reaches only those contracts or combinations in restraint of trade which unreasonably restrain trade or are designed to destroy competition in a particular market. People v. Colo. Springs Bd. of Realtors, 692 P.2d 1055 (Colo. 1984).

Illegal restraint of trade act applicable to title insurance. The state's illegal restraint of trade act is applicable to the business of title insurance. Commander Leasing Co. v. Transamerica Title Ins. Co., 477 F.2d 77 (10th Cir. 1973).

A coroner may not conspire with a private funeral home to acquire business for the funeral home through the discharge of his public duties in restraint of trade among all private funeral homes. People ex rel. Kinsey v. Sumner, 34 Colo. App. 61, 525 P.2d 512 (1974).

What establishes restraint of trade. Plaintiffs have a remedy under the Colorado restraint of trade act only to the extent that they can establish that there was a combination or conspiracy in restraint of trade or commerce in Colorado, or a combination or conspiracy fixing prices, or a combination and conspiracy which monopolized or attempted to monopolize trade or commerce in Colorado. Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975).

Federal antitrust laws. Federal and state antitrust statutes serve complementary purposes. In view of their common goals of preserving free competition and protecting the public against illegal restraints of trade, the antitrust decisions of the United States supreme court are entitled to careful consideration in determining the meaning and scope of the Colorado antitrust

statute. People v. North Ave. Furn. & Appliance, Inc., 645 P.2d 1291 (Colo. 1982).

Economic power means that a single seller possesses the ability to raise prices and restrict output for the product in the relevant market. Economic power can be established by showing that the tying product is unavailable elsewhere or is particularly unique and desirable or that the defendant has a dominant position in the tying market. Factual uniqueness alone is insufficient. The markets in which products are sold is the focus of any inquiry into the validity of a tying arrangement. The impact on competition of a single forced sale of a tied product to a single customer is never sufficient to warrant a finding of market power over the tying product. McCormick v. Bradley, 870 P.2d 599 (Colo. App. 1993).

No claim presented under this section where discharged employee was not injured "by reason of" alleged anticompetitive effect of employer's conduct. Winther v. DEC Inter'l Inc., 625 F. Supp. 100 (D. Colo. 1985).

Three types of restraint of trade. The two sentences in this section appear to define three different types of illegal restraints of trade. Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975).

Monopolization limited to conspiracy, etc. Given the grammar of this section, it must be concluded that monopolization or attempted monopolization is limited to a combination, conspiracy, trust, or pool because it is inconceivable that a contract or agreement could, in itself, monopolize or attempt to monopolize trade or commerce. Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975).

Group boycott. The term "group boycott" refers to a concerted refusal by traders to deal with competitors. Under the circumstances, the state failed to establish that requirement of board of realtors membership for access to multiple listing service was group boycott or refusal to deal with competitors which constituted per se violation of antitrust statute. People v. Colo. Springs Bd. of Realtors, 692 P.2d 1055 (Colo. 1984).

An illegal tying contract is irrelevant to this section because such contracts are not prohibited by it. Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975).

Tying arrangement. The essential characteristic of any tying arrangement is an agreement to sell one product but only on the condition that the buyer also purchase a different (or tied) product. Tying arrangements constitute unreasonable restraints of trade in and of themselves per se whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product and a not insubstantial amount of interstate commerce is affected, but mere fact that goods or services are sold in combination does not establish prohibited tying arrangement. People v. Colo. Springs Bd. of Realtors, 692 P.2d 1055 (Colo. 1984).

Test applied in McCormick v. Bradley, 870 P.2d 599 (Colo. App. 1993).

Determination of violation. Any particular business agreement, combination, or arrangement may in some circumstances be determined to constitute a per se violation of the statute, without the necessity of proving actual anticompetitive impact on the particular market involved. Additionally, a business arrangement which does not per se violate antitrust law nevertheless may be found to constitute an illegal arrangement under the rule of reason analysis articulated by the United States supreme court. Thus, in determining whether particular conduct violates this section, a trial court must normally determine whether the challenged arrangement is illegal per se. If no per se violation is established, the court may be required to apply the rule of reason analysis to the challenged conduct. People v. Colo. Springs Bd. of Realtors, 692 P.2d 1055 (Colo. 1984).

Test applied in McCormick v. Bradley, 870 P.2d 599 (Colo. App. 1993).

Where violation of statute consisted of the adoption of two specific membership criteria, and neither criteria were applied to deny membership to any applicant, nor were any damages sustained by any party as the result of the violator's adoption of such criteria, the appropriate sanction is to prohibit the violator from enforcing the offensive membership criteria. Colo. Springs Bd. of Realtors v. State, 780 P.2d 494 (Colo. 1989).

Per se antitrust violation. Developer's requirement that only approved builders may construct homes on lots is not a per se antitrust violation where unapproved builder failed to establish a substantial amount of commerce within the tied market had been foreclosed. McCormick v. Bradley, 870 P.2d 599 (Colo. App. 1993).

Rule of reason required the trial court to weigh the pro-competitive and anti-competitive effects of the two membership criteria. Colo. Springs Bd. of Realtors v. State, 780 P.2d 494 (Colo. 1989); McCormick v. Bradley, 870 P.2d 599 (Colo. App. 1993).

Test applied in McCormick v. Bradley, 870 P.2d 599 (Colo. App. 1993).

In terms of evidentiary production, no bright line is available to distinguish per se from rule of reason analysis. Colo. Springs Bd. of Realtors v. State, 780 P.2d 494 (Colo. 1989).

Where court applied rule of reason analysis to facts of case and concluded that anticompetitive effects of certain criteria outweighed any pro-competitive results their adoption might have engendered, in adopting these two membership criteria the violator improperly refused to deal with competitors and

that such group boycott violated this section. Colo. Springs Bd. of Realtors v. State, 780 P.2d 494 (Colo. 1989).

Criminal statutes must be construed strictly. Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975).

Installation of carpeting for money is "trade or commerce" within the meaning of this section. That the installation involves the exchange of a service for money, rather than the exchange of an article or commodity, is a distinction without antitrust significance. People v. North Ave. Furn. & Appliance, Inc., 645 P.2d 1291 (Colo. 1982).

For history of this article, see People v. North Ave. Furn. & Appliance, Inc., 645 P.2d 1291 (Colo. 1982).

Applied in Colo. Petroleum Marketers Ass'n v. Southland Corp., 476 F. Supp. 373 (D. Colo. 1979); Nat'l Cigarette Serv. Co. v. Farr, 42 Colo. App. 356, 594 P.2d 603 (1979); Colo. High Sch. Activities Ass'n v. Nat'l Football League, 524 F. Supp. 60 (D. Colo. 1981); Colo. High Sch. Activities Ass'n v. Nat'l Football League, 711 F.2d 943 (10th Cir. 1983).

6-4-105. Monopolization and attempt to monopolize. It is illegal for any person to monopolize, attempt to monopolize, or combine or conspire with any other person to monopolize any part of trade or commerce.

Source: L. 92: Entire article R&RE, p. 237, § 1, effective July 1.

Editor's note: This section is similar to former § 6-4-102, as it existed prior to 1992.

ANNOTATION

Law reviews. For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967). For article, "May Regulated Utilities Monopolize the Sun?", see 56 Den. L.J. 31 (1979). For article, "Colorado Antitrust Law Seven Years Later", see 13 Colo. Law. 1808 (1984). For article, "Antitrust Law", which discusses recent Tenth Circuit decisions dealing with antitrust law, see 62 Den. U. L. Rev. 183 (1986). For article, "Antitrust in the Health Care Field — Subject Matter Jurisdiction", see 18 Colo. Law. 1113 (1989). For article, "Does a Monopolist Have a Duty to Deal with Its Rival? Some Thoughts on the Aspen Skiing Case", see 57 U. Colo. L. Rev. 727 (1986). For article, "United States Supreme Court Review of Tenth Circuit Decisions", which discusses the Aspen Skiing Co. case, see 64 Den. U. L. Rev. 373 (1987).

A monopoly leveraging claim must prove threatened or actual monopoly in the leveraged market. Spruce Oil Corp. v. Archer-Daniel-Midland Co., 870 F. Supp. 1005 (D. Colo. 1994).

Applied in Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975) (decided under § 6-4-102 as it existed prior to the 1992 repeal and reenactment of this article); Nobody in Particular Presents, Inc. v. Clear Channel Commc'ns, Inc., 311 F. Supp. 2d (D. Colo. 2004) (because Colorado law mirrors federal antitrust law under the Sherman Act, court examined claims under federal law as dispositive of state law claims).

6-4-106. Bid-rigging. (1) It is illegal for any person to contract, combine, or conspire with any person to rig any bid, or any aspect of the bidding process, in any way related to the provision of any commodity or service.

(2) For purposes of this section, each separate instance of bid-rigging shall constitute a separate violation of this section, regardless of whether a single conspiracy is found to exist encompassing more than one such violation.

Source: L. 92: Entire article R&RE, p. 237, § 1, effective July 1.

Editor's note: This section is similar to former § 6-4-102, as it existed prior to 1992.

6-4-107. Mergers - acquisitions. (1) It is unlawful for any person engaged in trade or commerce to acquire, directly or indirectly, the whole or any part of the stock or other share capital, or to acquire the whole or any part of the assets, of another person engaged in trade or commerce where the effect of such acquisition may be to substantially lessen

competition or may tend to create a monopoly.

(2) Nothing in this section shall prohibit any person from acquiring stock of another person solely for investment purposes, so long as such acquisition of stock is not used, by voting or otherwise, to bring about, or to attempt to bring about, the substantial lessening of competition; nor shall anything in this section prohibit any person from causing the formation of subsidiary corporations or from owning and holding all or any part of the stock of such subsidiary corporation.

(3) The attorney general shall not challenge any merger or acquisition under the provisions of this section which has been reviewed by any federal department, agency, or commission under section 7A of the federal "Clayton Act" and for which all applicable waiting periods have expired or have been terminated without a challenge to such merger or acquisition by that department, agency, or commission.

(4) The attorney general shall not challenge the merger or acquisition of any bank or bank holding company by or with any other bank or bank holding company that is subject to the provisions of any of the federal banking laws, except as specifically provided in those laws.

Source: L. 92: Entire article R&RE, p. 237, § 1, effective July 1.

Cross references: For the "Clayton Act", see 38 Stat. 730; for section 7A of the "Clayton Act", as referred to in subsection (3), see 15 U.S.C. sec. 18a.

ANNOTATION

Law reviews. For article, "Antitrust Developments: U.S. Supreme Court Cases - 1989-1990 Term", see 20 Colo. Law. (1991).

6-4-108. Exemptions. (1) The labor of a human being is not a commodity, service, or article of trade or commerce.

(2) Nothing contained in this article shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for purposes of mutual help, or engaged in making collective sales or marketing for its members or shareholders, and not having capital stock or conducted for profit, or to forbid or restrain individual members of such organizations from lawfully carrying out the legitimate objects thereof.

(3) A professional review committee constituted and conducting its reviews and activities in accordance with the provisions of part 1 of article 36.5 of title 12, C.R.S., or the members thereof, shall not be held nor construed to be illegal combinations or conspiracies in restraint of trade under this article.

(4) Any person, activity, or conduct exempt or immune under the laws of this state or exempt or immune from the provisions of the federal antitrust laws shall be exempt or immune from the provisions of this article without regard to any monetary threshold imposed by federal law; except that nothing in this article shall be deemed to modify the specific provisions of part 4 of article 4 of title 10, C.R.S.

(5) Nothing in this article shall prohibit or be construed to prohibit:

(a) The formation of a cooperative health care agreement that has been approved in whole or in part in accordance with the provisions of part 5 of article 1 of title 25.5, C.R.S.;

(b) Any conduct or activity reasonably necessary and reasonably foreseeable to implement a board-approved cooperative health care agreement or a decision or order issued by the cooperative health care agreements board pursuant to part 5 of article 1 of title 25.5, C.R.S.;

(c) The negotiation of or entering into any cooperative health care agreement which is filed with the cooperative health care agreements board; or

(d) Community planning, discussions, or negotiations intended in good faith to culminate in a cooperative health care agreement to be filed with the cooperative health care

agreements board. Such agreements, conduct, or activities shall not be held or construed to be illegal combinations or conspiracies in restraint of trade under this article.

(6) Nothing in this article shall prohibit or be construed to prohibit the formation and operation of health care coverage cooperatives or provider networks pursuant to part 3 of article 18 of this title or part 10 of article 16 of title 10, C.R.S.

Source: L. 92: Entire article R&RE, p. 238, § 1, effective July 1. **L. 93:** (5) added, p. 1898, § 2, effective July 1. **L. 94:** (6) added, p. 1941, § 5, effective July 1. **L. 95:** (5)(a) and (5)(b) amended, p. 511, § 6, effective May 16. **L. 2004:** (6) amended, p. 1009, § 16, effective August 4.

Editor's note: This section is similar to former § 6-4-103, as it existed prior to 1992.

ANNOTATION

Law reviews. For article, "May Regulated Utilities Monopolize the Sun?", see 56 Den. L.J. 31 (1979). For comment, "Antitrust Law in Colorado: Back on Track", see 60 Den. L.J. 645 (1983). For article, "Colorado Antitrust Law Seven Years Later", see 13 Colo. Law. 1808 (1984).

Annotator's note. Since § 6-4-108 is similar to § 6-4-103 as it existed prior to the 1992 repeal and reenactment of this article, a relevant case construing that provision has been included in the annotations to this section.

Applicability of labor exemption. The Colorado labor exemption in subsection (2) (now subsection (1)) applies to those concerted employee activities arising out of an employment relationship and directed to the improvement of wages, hours of work and other conditions of employment. People v. North Ave. Furn. & Appliance, Inc., 645 P.2d 1291 (Colo. 1982).

Subsection (2) does not broaden the scope of the labor exemption. People v. North Ave. Furn. & Appliance, Inc., 645 P.2d 1291 (Colo. 1982) (referring to what is now subsection (1)).

6-4-109. Jurisdiction - venue. (1) Primary jurisdiction of any cause of action brought pursuant to this article shall be vested in the district courts of this state.

(2) Any cause of action brought pursuant to this article may be brought in any judicial district in which said violation occurred, in which any injury was suffered, or in which any defendant resides.

Source: L. 92: Entire article R&RE, p. 239, § 1, effective July 1.

Editor's note: This section is similar to former § 6-4-105, as it existed prior to 1992.

6-4-110. Civil discovery request. (1) When the attorney general has reasonable cause to believe that any person has engaged in or is engaging in a violation of any provision of this article or of any provision of the federal antitrust statutes that may be enforced by the attorney general, the attorney general may:

(a) Request such person to file a statement or report in writing, under oath or otherwise, on forms prescribed by the attorney general, or to answer in writing, under oath or otherwise, any questions propounded by the attorney general, as to all facts and circumstances reasonably related to the alleged violation and to provide any other data and information the attorney general reasonably deems to be necessary;

(b) Issue subpoenas to require the attendance of witnesses or the production of relevant documents, administer oaths, conduct hearings in aid of an investigation or inquiry, and prescribe such forms and promulgate such rules as may reasonably be deemed to be necessary to administer the provisions of this section; and

(c) Make true copies, at the expense of the attorney general, of any documents examined pursuant to paragraph (b) of this subsection (1), which copies may be offered into evidence in lieu of the originals thereof in any civil action brought pursuant to this article. The person producing the documents may require that the attorney general make copies of the documents. If the attorney general determines the use of originals is necessary, the attorney general shall pay to have copies of those documents made for use by the person producing the documents.

(2) Service of any request or subpoena shall be made in the manner prescribed by law.

(3) Any written response, testimony, or documents obtained by the attorney general pursuant to this section, or any information derived directly or indirectly from such written response, testimony, or documents, shall not be admissible in evidence in any criminal prosecution against the person providing the written response, testimony, or documents. The provisions of this subsection (3) shall not be construed to prevent any law enforcement officer, having an independent basis therefor, from producing or obtaining the same or similar facts, information, or evidence for use in any criminal prosecution.

(4) Nothing in this section shall prohibit the attorney general from disclosing information obtained pursuant to this section to any other law enforcement agency or department of any governmental or public entity of this or any other state or to the federal government if such other law enforcement agency or department executes an agreement that such information will remain confidential and will not be used in any criminal prosecution against the person providing the written response, testimony, or documents.

(5) If any person fails to appear or fails to cooperate with any investigation or inquiry pursuant to a request or subpoena issued pursuant to this section, the attorney general may apply to any district court for an appropriate order to effect the purposes of this section. The application shall state that there is reasonable cause to believe that the order applied for is necessary to investigate, prosecute, or terminate a violation of this article. If the court is satisfied that reasonable cause exists, the court may:

(a) Require the attendance of, or the production of documents by, such person, or both;

(b) Assess a civil penalty of up to five thousand dollars for such failure to appear and answer questions, written or otherwise, or such failure to produce documents unless the court finds that the failure to appear, to answer questions, or to produce documents was substantially justified or that other circumstances make an assessment of a civil penalty unjust;

(c) Award the attorney general reasonable costs and attorney fees in making this application unless the court finds that the failure to appear, to answer questions, or to produce documents was substantially justified or that other circumstances make an award of costs and attorney fees unjust;

(d) Enter any protective order as provided for in the Colorado rules of civil procedure; and

(e) Grant such other or further relief as may be necessary to obtain compliance by such person.

Source: L. 92: Entire article R&RE, p. 239, § 1, effective July 1. **L. 2000:** IP(1) amended, p. 245, § 4, effective March 30.

6-4-111. Enforcement by the attorney general. (1) The attorney general shall have the authority to institute actions or proceedings to prevent or restrain violations of this article.

(2) The attorney general may bring a civil action on behalf of any governmental or public entity, with the written consent of such entity, injured, either directly or indirectly, in its business or property by reason of any violation of this article and, if successful, shall recover any actual damages sustained by such entity. If the violation alleged and proved is determined by the court to be a *per se* violation of this article, the attorney general may recover three times the actual damages sustained by such entity.

(3) (a) The attorney general may bring a civil action as *parens patriae* on behalf of natural persons residing within the state injured in their business or property by reason of any violation of this article and, if successful, shall recover any actual damages sustained by such natural persons. If the violation alleged and proved is determined by the court to be a *per se* violation of this article, the attorney general may recover three times the actual damages sustained by such natural persons.

(b) In any *parens patriae* action brought pursuant to paragraph (a) of this subsection (3), the attorney general shall cause notice to be given to the proposed *parens* group by publication or as otherwise directed by the court, and all proposed *parens* group members shall have the right to elect to have their particular claim excluded from that proceeding. No

dismissal or compromise settlement of an action brought by the attorney general as *parens patriae* shall be entered without the approval of the court and notice to all proposed *parens* group members.

(c) In any *parens patriae* action in which actual or treble damages are recovered, the court, in its discretion, may determine that the amount of damages recovered is too small to make a refund to *parens* group members practicable. In that event, the court may direct such damages to be paid to the general fund of the state or to some other governmental or public entity as the court deems appropriate or may require that damages be paid as rebates or price reductions to future consumers.

(4) In any action brought pursuant to this section, the attorney general, if successful, shall be entitled to recover the costs of investigation, expert fees, costs of the action, and reasonable attorney fees.

Source: L. 92: Entire article R&RE, p. 241, § 1, effective July 1. **L. 93:** (1) amended, p. 1574, § 4, effective July 1.

ANNOTATION

Law reviews. For article, "Colorado Antitrust Law Seven Years Later", see 13 Colo. Law. 1808 (1984).

6-4-112. Civil penalties. (1) The attorney general may bring a civil action on behalf of the state to seek the imposition of a civil penalty for any violation of this article. The court, upon finding a violation of this article, shall impose a civil penalty to be paid to the general fund of the state in an amount not to exceed two hundred fifty thousand dollars for each such violation; except that the election by the attorney general to seek a civil penalty shall preclude the attorney general from filing criminal charges against the person assessed a civil penalty based upon the same conduct or from pursuing an action against such person for damages pursuant to section 6-4-111 (2) and (3).

(2) In determining the amount of a civil penalty, the court shall consider, among other things: The nature and extent of the violation; the number of consumers affected by the violation; whether the violation was an isolated incident or a continuous pattern and practice of behavior; whether the violation was the result of willful conduct; whether the defendant took affirmative steps to conceal such violations; and whether, given the size and wealth of the defendant, the civil penalty will be an effective deterrent against future violations.

Source: L. 92: Entire article R&RE, p. 242, § 1, effective July 1. **L. 93:** (1) amended, p. 1574, § 5, effective July 1. **L. 2009:** (1) amended, (SB 09-054), ch. 138, p. 597, § 2, effective August 5.

Editor's note: This section is similar to former § 6-4-107, as it existed prior to 1992.

6-4-113. Enforcement - injunction. (1) Any person injured in its business or property by reason of any violation of this article may file an action to prevent or restrain any such violation.

(2) In any action brought pursuant to this section, the court, in its discretion, may award the prevailing party its expert witness fees, the costs of the action, and reasonable attorney fees.

Source: L. 92: Entire article R&RE, p. 242, § 1, effective July 1.

Editor's note: This section is similar to former § 6-4-105, as it existed prior to 1992.

ANNOTATION

Law reviews. For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967). For article, "Colorado Antitrust Law Seven Years Later", see 13 Colo. Law. 1808 (1984). For article, "Antitrust Law", which discusses recent Tenth Circuit decisions dealing with antitrust law, see 62 Den. U. L. Rev. 183 (1986). For article, "Antitrust in the Health Care Field — Subject Matter Jurisdiction", see 18 Colo. Law. 1113 (1989).

6-4-114. Enforcement - civil damages. (1) Any person injured in its business or property by reason of any violation of this article may sue therefor and, if successful, shall recover any actual damages sustained by such person. If the violation alleged and proved is determined by the court to be a *per se* violation of this article, such person may recover three times the actual damages sustained by such person.

(2) In any action brought pursuant to this section, the court, in its discretion, may award the prevailing party its expert fees, the costs of the action, and reasonable attorney fees.

(3) No damages, costs, expert fees, costs of investigation, civil penalties, or attorney fees may be recovered from a governmental or public entity, or from any official, agent, or employee thereof acting in an official capacity, or from any person based on any official action directed by such governmental or public entity.

Source: L. 92: Entire article R&RE, p. 242, § 1, effective July 1.

Editor's note: This section is similar to former § 6-4-108, as it existed prior to 1992.

ANNOTATION

Law reviews. For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967). For article, "Colorado Antitrust Law Seven Years Later", see 13 Colo. Law. 1808 (1984).

Annotator's note. Since § 6-4-114 is similar to § 6-4-108 as it existed prior the 1992 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

End users of software lacked standing to pursue a class action claim under this section. Software was obtained by end user class members from original equipment manufacturers and retailers rather than from the software manufacturer and was licensed through an end user licensing agreement. The licensing agreement was the functional equivalent of a sale, and the end users, though licensees, were therefore essentially indirect purchasers of the software precluded from pursuing a claim under Illinois Brick Co. v. Illinois, 431 U.S. 720, 97 S. Ct. 2061, 52 L.Ed.2d 707 (1977). Pomerantz v. Microsoft Corp., 50 P.3d 929 (Colo. App. 2002).

The end user licensing agreements did not create functional economic unity between software manufacturer and original equipment manufacturers and retailers, and the end users, therefore, were not direct purchasers of software. Pomerantz v. Microsoft Corp., 50 P.3d 929 (Colo. App. 2002).

No claim presented under this section where discharged employee was not injured "by reason of" alleged anticompetitive effect of employer's conduct. Winther v. DEC Int'l Inc., 625 F. Supp. 100 (D. Colo. 1985).

Applied in Colo. Petroleum Marketers Ass'n v. Southland Corp., 476 F. Supp. 373 (D. Colo. 1979).

6-4-115. Notice to the attorney general. Any person who files a civil action which includes any allegation of a violation of this article shall, simultaneously with the filing of such action in district court, serve a copy of said complaint on the attorney general.

Source: L. 92: Entire article R&RE, p. 243, § 1, effective July 1.

6-4-116. Computation of damages. In any action brought pursuant to sections 6-4-111 and 6-4-114, the amount of damages may be calculated and assessed in the aggregate by statistical or sampling methods, by the computation of illegal overcharges, or by such other reasonable system of estimating aggregate damages as the court in its discretion may permit without the necessity of separately proving the individual claim of, or amount of damages to, persons on whose behalf the action was brought.

Source: L. 92: Entire article R&RE, p. 243, § 1, effective July 1.

Editor's note: This section is similar to former § 6-4-108, as it existed prior to 1992.

6-4-117. Enforcement - criminal proceedings. (1) The attorney general shall prosecute all criminal proceedings for violations of this article, whether by indictment or direct information filed in the appropriate district court.

(2) Any natural person who violates section 6-4-104, 6-4-105, or 6-4-106 commits a class 5 felony and shall be punished as provided in section 18-1.3-401, C.R.S.

(3) Any person, other than a natural person and a governmental or public entity, that violates section 6-4-104, 6-4-105, or 6-4-106 is guilty of a felony and, upon conviction thereof, shall be punished by a fine of not more than one million dollars.

Source: L. 92: Entire article R&RE, p. 243, § 1, **L. 2002:** (2) amended, p. 1466, § 15, effective October 1.

Editor's note: This section is similar to former § 6-4-104, as it existed prior to 1992.

Cross references: For the legislative declaration contained in the 2002 act amending subsection (2), see section 1 of chapter 318, Session Laws of Colorado 2002.

ANNOTATION

Law reviews. For article, "Criminal Prosecutions under the Colorado Securities Act", see 47 U. Colo. L. Rev. 233 (1976). For article, "Colorado Antitrust Law Seven Years Later", see 13 Colo. Law. 1808 (1984).

Criminal statutes must be construed strictly. Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975) (decided under § 6-4-107 as it existed prior to the 1992 repeal and reenactment of this article).

6-4-118. Statute of limitations. (1) Any civil action commenced pursuant to this article shall be brought within four years from the date that such cause of action accrued. For purposes of this article, a cause of action accrues when the circumstances giving rise to the cause of action are discovered or should have been discovered in the exercise of reasonable diligence.

(2) Any criminal proceeding brought pursuant to this article shall be commenced within six years after the act complained of occurred.

(3) If any proceeding or action is commenced by the attorney general for any violation of this article, the running of the statute of limitations with respect to every cause of action based in whole or in part on any matter complained of therein shall be suspended during the pendency thereof and for one year thereafter.

Source: L. 92: Entire article R&RE, p. 243, § 1, effective July 1.

Editor's note: This section is similar to former § 6-4-104, as it existed prior to 1992.

6-4-119. Interpretation. It is the intent of the general assembly that, in construing this article, the courts shall use as a guide interpretations given by the federal courts to comparable federal antitrust laws.

Source: L. 92: Entire article R&RE, p. 244, § 1, effective July 1.

ANNOTATION

Federal cases construing the Sherman and Clayton Acts, although not controlling, are entitled to careful scrutiny in resolving issues arising under Colorado's antitrust statute. Smalley and Co. v. Emerson and Cuming, Inc., 808 F. Supp. 1503 (D. Colo. 1992).

A municipality and cooperative electric association are immune from state antitrust liability when it is shown that the anticompetitive conduct at issue was undertaken pursuant to clearly articulated state policy. City of Colo. Springs v. Mountain View Elec. Ass'n, Inc., 925 P.2d 1378 (Colo. App. 1995).

6-4-120. Remedies - cumulative. The remedies provided in this article are cumulative except as otherwise expressly limited.

Source: L. 92: Entire article R&RE, p. 244, § 1, effective July 1.

Editor's note: This section is similar to former § 6-5-114, as it existed prior to 1992.

6-4-121. Void contracts - refund. All contracts or agreements made by any person while a member of any combination, conspiracy, trust, or pool prohibited under this article which are founded upon, or are the result of, or grow out of, or are connected with any violation of this article, either directly or indirectly, shall be void, and no recovery thereon or benefit therefrom shall be had by or for any such person. Any payments made upon, under, or pursuant to such contract or agreement to or for the benefit of such person may be recovered in an action by the party making the payment or his heirs, personal representatives, or assigns.

Source: L. 92: Entire article R&RE, p. 244, § 1, effective July 1.

Editor's note: This section is similar to former § 6-4-106, as it existed prior to 1992.

ANNOTATION

Law reviews. For article, "Antitrust and the Lay Lawyer", see 44 Den. L.J. 558 (1967). For article, "Colorado Antitrust Law Seven Years Later", see 13 Colo. Law. 1808 (1984).

Annotator's note. Since § 6-4-121 is similar to § 6-4-106 as it existed prior the 1992 repeal and reenactment of this article, relevant cases construing that provision have been included in the annotations to this section.

This section presupposes a violation of the Colorado Antitrust Act of 1992. Software end users who lacked standing to maintain an action under other sections of the Act thus also lacked standing to seek relief under this section. Pomerantz v. Microsoft Corp., 50 P.3d 929 (Colo. App. 2002).

Applied in Q-T Mkts., Inc. v. Fleming Cos., 394 F. Supp. 1102 (D. Colo. 1975); Frontier Airlines, Inc. v. United Airlines, Inc., 758 F. Supp. 1399 (D. Colo. 1989).

6-4-122. Severability. If any provision of this article or the application thereof to any person or circumstances is held invalid, that invalidity shall not affect other provisions or applications of the article which can be given effect without the invalid provision or application.

Source: L. 92: Entire article R&RE, p. 244, § 1, effective July 1.

ARTICLE 5

Unfair Cigarette Sales

6-5-101 to 6-5-114. (Repealed)

Source: L. 75: Entire article repealed, p. 261, § 1, effective July 1.

Editor's note: This article was numbered as article 3 of chapter 55, C.R.S. 1963. For amendments to this article prior to its repeal in 1975, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

ARTICLE 6

Unsolicited Goods

6-6-101. Definitions. As used in this article, unless the context otherwise requires:

(1) "Unsolicited goods" means contractual obligations or other tangible or intangible property or services delivered to a person who has not ordered, solicited, or agreed to purchase them, but shall not include tangible or intangible goods or services which are misdirected, misdelivered, or offered in good faith in substitution for goods solicited by the recipient.

Source: L. 75: Entire article added, p. 262, § 1, effective July 14. **L. 93:** (1) amended, p. 1574, § 6, effective July 1.

6-6-102. Obligation of recipient. (1) Unless otherwise agreed, where unsolicited goods are delivered to a person, he has a right to refuse to accept delivery of the goods and is not bound to return such goods to the sender.

(2) If such unsolicited goods are either addressed to or intended for the recipient, they shall be deemed a gift to the recipient, who may use them or dispose of them in any manner he sees fit without any obligation to the sender.

Source: L. 75: Entire article added, p. 262, § 1, effective July 14.

6-6-103. Collections prohibited - penalty. (1) No sender of any unsolicited goods shall mail or otherwise send to any recipient of such unsolicited goods a bill for such unsolicited goods or any dunning communications.

(2) (a) The sender of a magazine or other periodical shall cancel a subscription if any invoice is returned by the recipient marked "cancel". Cancellation shall also occur when the recipient gives written notice of cancellation to the sender at the sender's address or at the address of the subscription department printed in the periodical, or, if no such department is listed, at the general business address of the periodical.

(b) Notice of cancellation may be given by regular mail, and is effective on the date received by the sender. Notice of cancellation need not take any particular form and is sufficient if it indicates by any form of written expression that the recipient wishes to terminate the subscription. Within sixty days after notice of cancellation for prepaid subscriptions, the sender shall refund to the recipient any amount paid for the subscription less the amount owed by the recipient for any periodicals, together with the postage thereon, if postage has been charged separately, received before the effective date of the notice of cancellation.

(c) For purposes of this subsection (2), "sender" means the publisher of a periodical, any person acting as the agent of such publisher, and any person purporting to act as the agent of such publisher, and a seller of the periodical.

(3) Violation of this section shall constitute a class 2 petty offense, and, upon conviction thereof, the violator shall be punished by a fine of not more than two hundred fifty dollars. Violation of this section shall also constitute a deceptive trade practice in violation of the "Colorado Consumer Protection Act", article 1 of this title, and shall be subject to remedies or penalties, or both, pursuant thereto.

Source: L. 75: Entire article added, p. 262, § 1, effective July 14. **L. 76:** Entire section amended, p. 297, § 11, effective May 20. **L. 93:** Entire section amended, p. 1574, § 7, effective July 1. **L. 95:** Entire section amended, p. 387, § 1, effective July 1.

ARTICLE 6.5

Soil and Hazard Analyses of Residential Construction

6-6.5-101. Disclosure to purchaser - penalty. (1) At least fourteen days prior to closing the sale of any new residence for human habitation, every developer or builder or their representatives shall provide the purchaser with a copy of a summary report of the analysis and the site recommendations. For sites in which significant potential for expansive soils is recognized, the builder or his representative shall supply each buyer with a copy of a publication detailing the problems associated with such soils, the building methods to address these problems during construction, and suggestions for care and maintenance to address such problems.

(2) In addition to any other liability or penalty, any builder or developer failing to provide the report or publication required by subsection (1) of this section shall be subject to a civil penalty of five hundred dollars payable to the purchaser.

(3) The requirements of this section shall not apply to any individual constructing a residential structure for his own residence.

Source: L. 84: Entire article added, p. 294, § 1, effective July 1.

ANNOTATION

Law reviews. For article, "Building on Expansive Soils: Colorado's Legislative Response", see 14 Colo. Law. 379 (1985).

Liability under this section applies to an individual operating on behalf of a corporate developer. Hoang v. Arbess, 80 P.3d 863 (Colo. App. 2003); Hildebrand v. New Vista Homes II, LLC, 252 P.3d 1159 (Colo. App. 2010).

ENERGY CONSERVATION

ARTICLE 7

Residential Building Energy Conservation

6-7-101. Short title. This article shall be known and may be cited as the "Residential Building Energy Conservation Act of 1977".

Source: L. 77: Entire article added, p. 354, § 1, effective July 1.

6-7-102. Legislative declaration. (1) The general assembly hereby finds and declares that:

(a) The energy resources of this state and the nation are essential to the preservation of the public health, welfare, and safety and to the maintenance of a healthy economy;

(b) The conservation and efficient use of said energy resources are necessary if the quality of life in this state is to be maintained and continued;

(c) The purpose of this article is to provide minimum uniform statewide insulation standards to achieve energy conservation in the construction and renovation of residential buildings and to encourage energy conservation by other means in the construction and renovation of residential buildings, recognizing that such energy conservation by insulation or other means must be life cycle cost-effective in order to minimize the adverse impact on

residential life-styles and to continue to strive to make reasonably priced housing available to all residents of this state;

(d) The general assembly recognizes the technological improvements developed by the home-building industry in connection with energy conservation for residential buildings and wishes to encourage continued technological improvement by the home-building industry in order to exceed the insulation energy conservation standards contained in this article;

(e) It is the further purpose to establish a process which will result in the development of residential energy conserving performance standards by September 1, 1977. Such standards shall consider all uses of energy generated by fossil fuels, used within a dwelling, including energy used for lighting, cooking, appliances, maintenance of air temperature, and heating water and the energy lost through the building envelope and exhaust pipes. It is consistent with public policy to encourage the rehabilitation, preservation, and restoration of buildings built before September 1, 1977.

Source: L. 77: Entire article added, p. 354, § 1, effective July 1. **L. 79:** (1)(e) amended, p. 319, § 1, effective July 1.

6-7-103. Definitions. As used in this article, unless the context otherwise requires:

(1) "Heating degree day" means a unit, based upon temperature difference and time, used in estimating fuel consumption and specifying nominal heating load of a building in winter. For any one day, when the mean temperature is less than sixty-five degrees Fahrenheit, there exist as many heating degree days as there are Fahrenheit degrees difference in temperature between the mean temperature for the day and sixty-five degrees Fahrenheit.

(2) "Local government" means a county or municipality and may be used to refer to the governing body thereof or the area under the jurisdiction of said governing body.

(3) "Municipality" means any home rule city, town, or city and county, statutory city or town, territorial charter city, or municipal corporation which incorporated pursuant to territorial or general incorporation law and which has not reorganized.

(4) "Overall thermal transmittance"(U_0) means the overall average heat transmission of a gross area of the exterior building envelope, expressed in British thermal units per hour per square foot per degree Fahrenheit. The U_0 value applies to the combined effect of the time rate of heat flows through the various parallel paths, such as windows, doors, and opaque construction areas, comprising the gross area of one or more exterior building components, such as walls, floors, or roofs or ceilings.

(5) "Renovation" means any additions, alterations, or repairs to an existing building. When additions, alterations, or repairs exceed fifty percent of the value of an existing building, such building shall be made to conform to the renovation standards promulgated by the board for energy efficient building standards. The renovation standards promulgated shall recognize the individuality of each renovation project. Any additions shall conform to the energy conservation requirements for new buildings as they relate to the new construction only.

(6) "Residential building" includes all one- and two-family dwellings or multifamily dwellings not to exceed three stories above grade.

(7) "R-value" (R=1/U) means the reciprocal of the average overall coefficient of heat transmission in BTUs (British thermal units) per hour per square foot per degree Fahrenheit. The term is generally applied to usual combinations of insulation materials, as generally recognized and accepted in the residential building construction industry.

(8) "Thermal transmittance" ((U) (U = 1/R)) means the overall coefficient of heat transmission, air to air, expressed in British thermal units per hour per square foot per degree Fahrenheit. It is the time rate of heat flow. The U value applies to combinations of different materials used in series along the heat flow path, single materials that comprise a building section, cavity air spaces, and surfaces air films on both sides of a building element.

(9) "Value" means the estimated cost to replace the building in kind, based on current replacement costs, as determined by the local building official.

Source: L. 77: Entire article added, p. 354, § 1, effective July 1. **L. 79:** Entire section R&RE, p. 319, § 2, effective July 1.

6-7-104. Exemptions from this article. The standards set forth in this article shall not apply to the design and construction or renovation of private garages, carports, sheds, agricultural buildings, tanks, factory-constructed housing, towers, and those buildings which have been designated as historic by the governing body of a county or municipality or which have been included on the state register of historic properties pursuant to article 80.1 of title 24, C.R.S., or the national register of historic places maintained pursuant to 16 U.S.C. sec. 470a.

Source: L. 77: Entire article added, p. 355, § 1, effective July 1. **L. 79:** Entire section amended, p. 320, § 3, effective July 1.

6-7-105. Insulation and thermal performance standards and energy conserving alternatives. (1) (a) The following design parameters shall be used for calculations required under this section. Computations submitted by a licensed architect or engineer, contractors, builders, and owners shall be considered as acceptable when calculated by acceptable engineering procedures. Values for table 1 are to be selected from standard RS21 of the Colorado energy conservation standards (design temperatures for Colorado cities and towns, supplement to climate data for air conditioning design, ASHRAE Rocky Mountain region, April, 1978).

Table 1

Location ______________________________

Winter design dry-bulb ______________________________ °F

Degree days heating ______________________________

(b) Minimum thermal performance standards for residential buildings on which construction commences on or after November 1, 1979, shall conform to one of the alternatives provided in subsections (2), (3), and (4) of this section. Renovation that commences on or after November 1, 1979, shall conform to one of the alternatives provided in subsections (2), (3), and (4) of this section, or renovation standards promulgated by the board for energy efficient building standards.

(2) (a) Any separate envelope component of a residential building that is heated shall not exceed the combined thermal transmittance value (U_0) derived from equation 1 using values in table 2. Values for the purposes of table 2 shall be determined by using the graphs (figures 1, 2, and 5) contained in the Colorado energy conservation standards. The combined thermal transmittance (U_r) for roofs or ceilings shall not exceed 0.05 BTU/H FT^2 °F for geographic areas with eight thousand or less Fahrenheit heating degree days and shall not exceed 0.04 BTU/H FT^2 °F for geographic areas with more than eight thousand Fahrenheit heating degree days. Roof or ceiling assemblies in which the finished interior surface is the underside of the roof deck may have a maximum U_r value of 0.08 BTU/H FT^2 °F. Equation 1 shall be used to determine acceptable combinations to meet the required U_0 values.

Table 2

Element	**Required value**
Walls	U_w ______________
Roof/ceiling	U_r ______________
Floors over unheated spaces	U_f ______________
Heated slab on grade	R ______________

(b) If all exposed concrete walls average less than two feet above grade, those walls are exempt from the calculations for U_w and insulation.

(c) Heating equipment shall be sized using climate data from table 1 in subsection (1) of this section.

(3) (a) If any segment (wall, floor, roof) of the exterior envelope does not comply with the standards prescribed in subsection (2) of this section, the thermal transmittance value (U_0) of any other segment (wall, floor, roof) may be decreased so that the resulting thermal transmittance value (U_0) of the envelope complies as if the building had been designed in compliance with subsection (2) of this section. For this purpose, reduction of the thermal transmittance value of any of the other exterior components of the envelopes may be used to achieve compliance.

Equation 1

$$U_0 \text{ Envelope} = \frac{U_{\mathbf{wall}} A_{\mathbf{wall}} + U_{\mathbf{roof}} A_{\mathbf{roof}} + U_{\mathbf{floor}} A_{\mathbf{floor}} \ldots}{A_{\text{wall}} + A_{\text{roof}} + A_{\text{floor}} \ldots}$$

(b) Use of the equation provided in paragraph (a) of this subsection (3) requires two sets of calculations. The first calculation utilizes the U_0 values obtained from subsection (2) of this section and the actual areas of the proposed residential design. The second calculation utilizes the actual U_0 values and the actual areas of the proposed residential design.

(4) Computations submitted indicating that the total fossil fuel energy required in a residential building, through design or otherwise, equals or is less than the total fossil fuel energy used if the dwelling is built or renovated according to standards contained in subsections (1) and (2) of this section shall be considered an acceptable alternative. The total fossil fuel energy required shall be computed as the annual estimated BTUs necessary for the proposed residential building.

(5) Repealed.

Source: L. 77: Entire article added, p. 355, § 1, effective July 1. **L. 79:** Entire section R&RE, p. 321, § 4, effective July 1. **L. 2004:** (1)(b) amended, p. 1188, § 8, effective August 4.

Editor's note: Subsection (5)(e) provided for the repeal of subsection (5), effective March 31, 1980. (See L. 79, p. 321.)

6-7-106. Building permits. (1) No building permit shall be issued for the construction or renovation of any residential buildings in any area under the jurisdiction of a local government on or after October 1, 1977, unless such construction or renovation will conform to the provisions of this article. The local building inspector shall inspect all places not inspected by the division of housing pursuant to part 7 of article 32 of title 24, C.R.S., to determine whether such places are in compliance with the insulation standards required by this article.

(2) Nothing in this article shall be construed to restrict or limit the authority of a county or municipality to adopt and enforce standards for efficient construction and renovation which are no less stringent than the standards contained in section 6-7-105. Any county or municipality adopting such standards may accept computations submitted by a licensed architect or licensed engineer that the design of the proposed building meets or exceeds the locally adopted energy efficiency standards.

Source: L. 77: Entire article added, p. 356, § 1, effective July 1.

AGRICULTURAL ASSISTANCE

ARTICLE 8

Assistance to the Agricultural Community

6-8-101 and 6-8-102. (Repealed)

Editor's note: (1) This article was added in 1986 and was not amended prior to its repeal in 1990. For the text of this article prior to 1990, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

(2) Section 6-8-102 provided for the repeal of this article, effective January 31, 1990. (See L. 86, p. 434.)

ARTICLE 9

Agricultural Mediation

6-9-101 to 6-9-107. (Repealed)

Editor's note: (1) This article was added in 1987 and was not amended prior to its repeal in 1989. For the text of this article prior to 1989, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

(2) Section 6-9-107 provided for the repeal of this article, effective January 31, 1989. (See L. 87, p. 1356.)

ASSIGNMENTS IN GENERAL

ARTICLE 10

Assignments in General

Law reviews: For a discussion of Tenth Circuit decisions dealing with questions of bankruptcy law, see 67 Den. U. L. Rev. 631 (1990).

6-10-101. Definitions. As used in this article, unless the context otherwise requires:

(1) "Person" means individuals, partnerships, associations, and corporations.

(2) "Property" means all goods, chattels and effects, real, personal and mixed property, money, rights and credits, and choses in action except property which is by law not subject to levy and sale under execution.

Source: L. 1897: p. 94, § 1. **R.S. 08:** § 174. **C.L.** § 6241. **CSA:** C. 12, § 1. **CRS 53:** § 11-1-1. **C.R.S. 1963:** § 11-1-1.

ANNOTATION

I. General Consideration.
II. Purpose.
III. Rules of Construction.
IV. Application.
V. Failure to Comply.

I. GENERAL CONSIDERATION.

Law reviews. For article, "Assignment of Contractual Rights in Colorado", see 5 Rocky Mt. L. Rev. 30 (1932). For article, "Validity of the Colorado Assignment Act", see 18 Dicta 274 (1941). For article, "One Year Review of Civil Procedure and Appeals", see 40 Den. L. Ctr. J. 66 (1963).

Annotator's note. Cases material to § 6-10-101 et seq. decided prior to its earliest source, L. 1897, p. 94, § 1 et seq., have been included in the annotations to this section.

While state insolvency laws are invalid, states may enact statutes providing for the voluntary assignment of debts for the benefit of creditors. In re Carlson's for Music, Inc. v. Gould, 176 Colo. 172, 489 P.2d 1038 (1971).

This article is full and complete within itself, as to all matters pertaining to assignments, and the general law concerning conveyances has no application. Spangler v. Sanborn, 7 Colo. App. 102, 43 P. 905 (1895).

For cases decided prior to the passage of the general assignment statute of 1885, see Ray v. Raynolds, 8 Colo. 467, 9 P. 15 (1885); Cornforth v. Maguire, 12 Colo. 432, 21 P. 191 (1889).

II. PURPOSE.

The purpose of this article is to enable an insolvent debtor by conveying all his property to an assignee for the benefit of his creditors to be discharged from his debts. Clark v. Bright, 30 Colo. 199, 69 P. 506 (1902).

Hence, the assignment article is, in effect, a bankruptcy act. Clark v. Bright, 30 Colo. 199, 69 P. 506 (1902).

Provisions acceptable in relation to federal bankruptcy act. Provisions of this article by which debtors may voluntarily assign their assets for the benefit of their creditors, but without discharge of the debts, are perfectly acceptable in relation to the federal bankruptcy act. In re Carlson's for Music, Inc. v. Gould, 176 Colo. 172, 489 P.2d 1038 (1971).

Provisions providing for discharge not acceptable, the provisions in this article providing for discharge of an assignor have been suspended by the federal bankruptcy act. In re Carlson's for Music, Inc. v. Gould, 176 Colo. 172, 489 P.2d 1038 (1971).

The act does not compel a debtor to relinquish possession or control of his property to an assignee or trustee for the benefit of his creditors when he becomes unable to pay his debts. Hayden v. Wellington, 63 F. 6 (8th Cir. 1894).

The insolvent laws of Colorado are of a purely voluntary character; they do not constrain persons to execute an assignment in the event of insolvency. Schindelholz v. Cullum, 55 F. 885 (8th Cir. 1893); Kellogg v. Thropp, 4 Colo. App. 470, 36 P. 447 (1893).

A compulsory assignment for the benefit of creditors is unknown. Kellogg v. Thropp, 4 Colo. App. 470, 36 P. 447 (1893).

This article gives one permission to make a transfer of this nature, with certain prescribed formalities, and it provides for the due administration of the estate when it has been thus assigned. Hayden v. Wellington, 63 F. 6 (8th Cir. 1894).

III. RULES OF CONSTRUCTION.

This article is in derogation of the common law. Damaskus v. McCarty-Johnson Heating & Eng'r Co., 88 Colo. 279, 295 P. 490 (1931); Markoff v. Barenberg, 149 Colo. 311, 368 P.2d 964 (1962).

It must be strictly construed. Damaskus v. McCarty-Johnson Heating & Eng'r Co., 88 Colo. 279, 295 P. 490 (1931).

IV. APPLICATION.

Assignments made for the benefit of creditors must strictly comply with all of the required details of this article before creditors of the assignor are bound thereby. Markoff v. Barenberg, 149 Colo. 311, 368 P.2d 964 (1962).

Article must be strictly pursued. The statutory law of assignments is remedial, in derogation of the rights of creditors, and must, like any other statutory remedy, be strictly pursued. Burchinell v. Mosconi, 4 Colo. App. 401, 36 P. 307 (1894).

Its provisions are mandatory. Burchinell v. Mosconi, 4 Colo. App. 401, 36 P. 307 (1894); Damaskus v. McCarty-Johnson Heating & Eng'r Co., 88 Colo. 279, 295 P. 490 (1931).

Any important departure avoids and vitiates the whole proceeding. Burchinell v. Mosconi, 4 Colo. App. 401, 36 P. 307 (1894).

However, in order to vitiate an assignment, it must be found lacking in one of the essentials. Hunter v. Ferguson, 3 Colo. App. 287, 33 P. 82 (1893).

V. FAILURE TO COMPLY.

Failure of the debtor to comply with this article constitutes a common law, and not a statutory, assignment. McKelvy v. Striker, 108 Colo. 320, 116 P.2d 921 (1941).

Assignment may be valid as common-law assignment. An assignment for the benefit of creditors, although insufficient under this article, may be valid as a common-law assignment. Damaskus v. McCarty-Johnson Heating & Eng'r Co., 88 Colo. 279, 295 P. 490 (1931).

Common-law assignments are valid, independent of statutory assignments. McKelvy v. Striker, 108 Colo. 320, 116 P.2d 921 (1941).

Since no mention is made in this article of common-law assignments and nothing therein contained either specifically or by implication is susceptible to the construction that its sections were intended to be an exclusive substitute for common-law assignments. Damaskus v. McCarty-Johnson Heating & Eng'r Co., 88 Colo. 279, 295 P. 490 (1931).

6-10-102. General assignment. Any person may make a general assignment for the benefit of his creditors by deed duly acknowledged. When filed for record in the office of the clerk and recorder of the county where the assignor resides or, if a nonresident, where his principal place of business is in this state, such deed shall vest in the assignee in trust for the use and benefit of such creditors all the property of the assignor, excepting only such as is by law not subject to levy and sale under execution, subject, however, to all valid and subsisting liens.

Source: L. 1897: p. 94, § 2. **R.S. 08:** § 175. **C.L.** § 6242. **CSA:** C. 12, § 2. **CRS 53:** § 11-1-2. **C.R.S. 1963:** § 11-1-2.

ANNOTATION

I. General Consideration.
II. Requisites and Form.
III. Title of Assignee.

I. GENERAL CONSIDERATION.

Annotator's note. Cases material to § 6-10-102 decided prior to its earliest source, L. 1897, p. 94, § 2, have been included in the annotations to § 6-10-102.

A general assignment is an act of bankruptcy. A general assignment, filed and recorded in pursuance of the statutes of Colorado, falls far within the established rule that the general assignment declared by the bankruptcy act to constitute an act of bankruptcy embraces any conveyance at common law or pursuant to statute by which the assignor intends to make and does make an absolute appropriation of his property not exempt from levy to pay all his

debts, although there may be some defect in the conveyance or some failure to comply with some law or statute in the proceeding he takes to effectuate his intention which does not prevent the actual appropriation of his property for the benefit of his creditors. Moore v. Yampa Mercantile Co., 287 F. 629 (8th Cir. 1923).

There is neither in terms nor by implication any duty cast upon an insolvent to dispose of his property by a general assignment. May v. Tenney, 148 U.S. 60, 13 S. Ct. 491, 37 L. Ed. 368 (1893).

II. REQUISITES AND FORM.

An assignment not made in accordance with this section is only a common-law assignment. McMinn v. Harrison, 93 Colo. 5, 23 P.2d 944 (1933).

An instrument that does not purport to be a transfer of all the grantor's property, but only of certain described items, together with incidentals used in connection with such, is, on its face no general assignment. May v. Tenney, 148 U.S. 60, 13 S. Ct. 491, 37 L. Ed. 368 (1893).

When the deed in general terms purports to convey all the property and afterwards enumerates and designates the property assigned, such special designation controls the general words, makes the assignment special instead of general, and renders the deed inoperative and void. Palmer v. McCarthy, 2 Colo. App. 422, 31 P. 241 (1892).

Where there are in the deed of conveyance no words evidencing either the desire or intention to convey all the property of the assignor, the only conclusion that can be legally deduced from the language used is that the assignment is to be special of the property enumerated. Palmer v. McCarthy, 2 Colo. App. 422, 31 P. 241 (1892).

Moreover, the fact that a debtor transfers all of his property to secure the payment of particular debts does not constitute an assignment for the benefit of creditors generally. Poundstone v. Holt, 5 Colo. App. 66, 37 P. 35 (1894).

Deed may refer to inventory for particular description of property. Where, according to the express language of the instrument, reference to the inventory is for a more full and particular description and not by way of limitation, then, it is the manifest and clear intention of the parties to convey all the property which they owned which is not exempt from execution, and this has always been held sufficient. Graham Paper Co. v. Sanderson, 8 Colo. App. 427, 47 P. 904 (1896).

III. TITLE OF ASSIGNEE.

Section applies whether assignor is solvent or insolvent. This provision regulating the administration of trusts created by voluntary assignments for the benefit of creditors applies whether the assignor is solvent or insolvent. In re Carlson's for Music, Inc. v. Gould, 176 Colo. 172, 489 P.2d 1038 (1971).

Such an assignment implies a trust and contemplates the intervention of a trustee. May v. Tenney, 148 U.S. 60, 13 S. Ct. 491, 37 L. Ed. 368 (1893).

The intent of this section appears to be to make the assignee not the mere representative of the assignor but the trustee of the assignor and the creditors for the purpose of marshaling the assets of the assignor for pro rata distribution among the creditors, returning the surplus, if any, to the assignor. Clark v. Bright, 30 Colo. 199, 69 P. 506 (1902).

Hence, the assignee becomes vested with right and title to the estate of the assignors for the purpose of paying the debts of the assignors in full, if sufficient therefor; if not, then ratably, except only as to the preference created by the said legislative enactment. And the assignee becomes charged with the duty of collecting the personal assets, wherever they might be found, and of distributing the proceeds of the entire estate among the creditors according to the provisions of this enactment. Ray v. Hiller, 11 Colo. 445, 18 P. 622 (1888).

Furthermore, it is by the language of the deed that the title of the assignee must be determined, without reference either to the inventory or the list of creditors. Falk v. Liebes, 6 Colo. App. 473, 42 P. 46 (1895).

If all requisites are not met assignee takes no title. If a deed of assignment fails in the essential particular specified by this section the want cannot be supplied by judicial decision; the deed would not invest the assignee with any title, and creditors could proceed against the debtor in the same manner and with the same effect as if no assignment had been attempted. Kellogg v. Thropp, 4 Colo. App. 470, 36 P. 447 (1894).

Property vests in assignee only when instrument is filed. The plain and necessary inference from the provision of this section that the instrument "when filed, etc. shall vest" is that when not filed it shall not vest. Kinney v. Yoelin Bros. Mercantile Co., 76 Colo. 136, 230 P. 127 (1924).

This means a filing for record in the proper county. Spangler v. Sanborn, 7 Colo. App. 102, 43 P. 905 (1895).

Nevertheless, this section does not make the record of the deed of assignment constructive notice to creditors, and the fact that notice is specifically provided for elsewhere, (as in § 6-10-108), is evidence that it was not intended to be such. Kinney v. Yoelin Bros. Mercantile Co., 76 Colo. 136, 230 P. 127 (1924).

Thus, title does not pass if instrument is not recorded. A power of attorney given by a

debtor to an assignee for the benefit of creditors does not pass title as against creditors where it is not recorded in accordance with this section. Kinney v. Yoelin Bros. Mercantile Co., 76 Colo. 136, 230 P. 127 (1924).

However, a deed of assignment does not destroy valid antecedent liens upon the assignor's property, nor the right of the holder to enforce them. Nat'l Bank of Commerce v. Graham, 16 Colo. App. 498, 66 P. 684 (1901).

Since the assignee takes the property subject to all subsisting valid liens. Nat'l Bank of Commerce v. Graham, 16 Colo. App. 498, 66 P. 684 (1901).

Where a corporation makes a general assignment for the benefit of its creditors and a receiver, later appointed, files a motion in the assignment proceedings asking the dismissal of the assignment proceedings and an order to compel the assignee to turn over to the receiver the property of the corporation, the title of the assignee to the property cannot be determined in such a proceeding. Flint v. Powell, 10 Colo. App. 66, 50 P. 45 (1897).

6-10-103. Inventory - list of creditors. The assignor shall render to such assignee within four days from the date of said assignment an inventory under oath, of his property, to the best of his knowledge, with the estimated value thereof, and also a list of his creditors, giving their names, residence and post-office address, if known, and the amount of their respective demands. Such inventory shall not be conclusive of the amount of the assignor's estate nor shall the omission of any property from such inventory defeat the assignment or conveyance of the same.

Source: L. 1897: p. 94, § 3. **R.S. 08:** § 176. **C.L.** § 6243. **CSA:** C. 12, § 3. **CRS 53:** § 11-1-3. **C.R.S. 1963:** § 11-1-3.

ANNOTATION

Annotator's note. Cases material to § 6-10-103 decided prior to its earliest source, L. 1897, p. 94, § 3, have been included in the annotations to this section.

This section requires a schedule under oath, a full and complete schedule, so far as the party has power to make it. Burchinell v. Mosconi, 4 Colo. App. 401, 36 P. 307 (1894).

Anything short of this is not compliance and avoids the assignment. Burchinell v. Mosconi, 4 Colo. App. 401, 36 P. 307 (1894).

The provisions of this section cannot be dispensed with. Palmer v. McCarthy, 2 Colo. App. 422, 31 P. 241 (1892).

So a material failure to comply with them or a serious departure vitiates the whole proceeding. Palmer v. McCarthy, 2 Colo. App. 422, 31 P. 241 (1892).

For without the inventory nothing passes. The inventory required by law, designates and defines the conveyance by showing the amount, quantity, and specific character of each and every part of the estate conveyed. Without it, the words of conveyance being so general, nothing passes, for there can be no identification; hence, the wisdom and necessity of a sworn inventory as required by this section, and of a strict compliance with it. Palmer v. McCarthy, 2 Colo. App. 422, 31 P. 241 (1892).

Under this section it is only requisite that the description be sufficient when aided by parol proof to ascertain what is granted. Graham Paper Co. v. Sanderson, 8 Colo. App. 427, 47 P. 904 (1896).

This section does not require the list of creditors to be verified. Falk v. Liebes, 6 Colo. App. 473, 42 P. 46 (1895).

Hence, an affidavit of which the inventory is a part, subscribed by the party, and the certificate of an officer that an oath was administered is an exact compliance with this section. Falk v. Liebes, 6 Colo. App. 473, 42 P. 46 (1895).

Formerly general description in assignment was limited and controlled by schedule attached. See Burchinell v. Mosconi, 4 Colo. App. 401, 36 P. 307 (1894).

Under the old assignment act of 1885 the assignor was bound to attach an inventory to his deed of assignment which should contain a description of the property which he sought to convey; in that case the deed itself declared that all the property which was conveyed was described in the schedule which was attached. Graham Paper Co. v. Sanderson, 8 Colo. App. 427, 47 P. 904 (1896).

Thus, the assignor was required to annex to his deed of assignment an inventory under oath of his estate; such inventory became a part and parcel of the conveyance. Burchinell v. Mosconi, 4 Colo. App. 401, 36 P. 307 (1894).

6-10-104. Assignment for all creditors. No such deed of general assignment of property by an insolvent, or in contemplation of insolvency, for the benefit of creditors, shall be valid, unless by its terms it is made for the benefit of all his creditors in proportion to the amount of their respective claims.

Source: L. 1897: p. 95, § 4. **R.S. 08:** § 177. **C.L.** § 6244. **CSA:** C. 12, § 4. **CRS 53:** § 11-1-4. **C.R.S. 1963:** § 11-1-4.

ANNOTATION

Annotator's note. Cases material to § 6-10-104 decided prior to its earliest source, L. 1897, p. 95, § 4, have been included in the annotations to this section.

The rule under this section is not that the preferences fail and the assignment stands, but that the assignment itself fails unless it be in terms free from preferences. May v. Tenney, 148 U.S. 60, 13 S. Ct. 491, 37 L. Ed. 368 (1893).

At common law there was no restriction upon the right of a debtor to prefer creditors. Kellogg v. Thropp, 4 Colo. App. 470, 36 P. 447 (1894).

Subject to the statutory provisions governing general assignments, this common-law right remains unimpaired in this state. Kellogg v. Thropp, 4 Colo. App. 470, 36 P. 447 (1894).

Thus, right to prefer creditors remains unimpaired if debtor retains dominion over property. There is nothing in this section from which it can be implied that it was the purpose of the general assembly to prevent a debtor, insolvent or not, from securing or paying one of his creditors in preference to another while he retains dominion over his property, except as he undertakes to do so in a deed of general assignment executed pursuant to the statute. Kellogg v. Thropp, 4 Colo. App. 470, 36 P. 447 (1894).

Lawful preferences working no prejudice to creditors are allowed. Where one secures a lawful preference by its superior diligence before a bill of sale in its favor is executed, no creditor of the debtor is prejudiced by the conveyance, inasmuch as such a conveyance makes the same disposition of the proceeds of the attached property which the law would have made if the attachment suit had been regularly prosecuted to final judgment. At common law the debtor had an undoubted right to enter into such an arrangement with his creditor, and there is no sufficient reason why the assignment act should receive a construction which will interdict such arrangements, if they are entered into in good faith and are not conceived with a view of evading the provisions of the assignment law. Hayden v. Wellington, 63 F. 6 (8th Cir. 1894).

Moreover, a secured creditor having credited upon his debt the proceeds of his security has a right to participate with other creditors and upon an equal footing with them in the assets realized from the assignment to the extent of the unpaid residue of his debt. Nat'l Bank of Commerce v. Graham, 16 Colo. App. 498, 66 P. 684 (1901).

The purpose of this section is not to discourage or restrain the making of general assignments, but to inhibit partiality therein toward favored creditors. Campbell v. Colo. Coal & Iron Co., 9 Colo. 60, 10 P. 248 (1885).

The provisions of this section that are regulatory of voluntary assignments serve to protect creditors against each other and go to assure equality of distribution unaffected by any requirement or condition in respect of discharge. In re Carlson's for Music, Inc. v. Gould, 176 Colo. 172, 489 P.2d 1038 (1971).

Thus, ratable participation must be provided for. When one voluntarily undertakes by deed of assignment to avail himself of the statute, he must make express provision for the ratable participation by his creditors in its benefits, or the deed is void. Kellogg v. Thropp, 4 Colo. App. 470, 36 P. 447 (1893).

An instrument which, in form an irrevocable power of attorney and obviously intended to operate as an assignment for the benefit of all creditors equally and without preference is, at least when possession is taken thereunder, a common-law assignment for the benefit of creditors. McMinn v. Harrison, 93 Colo. 5, 23 P.2d 944 (1933).

When a deed of assignment is not made for the benefit of all creditors, and some of them are expressly and by intention excluded from its benefits, the deed cannot be upheld. Stevens v. Mosconi, 5 Colo. App. 484, 39 P. 348 (1895).

So a conveyance, unquestionably a general assignment, in form which contemplates the payment only two creditors is not only not for the benefit of all creditors, but avowedly for the benefit of the two, and would, therefore, have to be adjudged a void instrument. May v. Tenney, 148 U.S. 60, 13 S. Ct. 491, 37 L. Ed. 368 (1893).

Such an assignment, whether so intended or not, is fraudulent under this section as not being for the benefit of all the creditors if it makes those who are named and scheduled preferred creditors. Burchinell v. Mosconi, 4 Colo. App. 401, 36 P. 307 (1894).

Fraud and illegality must be pleaded in court below. Where it is alleged that an assignment in favor of certain creditors to the exclusion of others is in violation of this section but no fraud or illegality in the assignment is

pleaded nor is any such question in any manner raised in the court below, it need not be determined on appeal whether such a defense can or cannot be successfully interposed. Marsh v. Cramer, 16 Colo. 331, 27 P. 169 (1891).

Furthermore, a preference by separate transaction shows intent to violate section. The fact that a preference is not provided for in an assignment itself, but by an arrangement or transfer outside of it and contemporaneous with it, shows the intent to evade and violate this section. Doggett, Bassett & Hills Co. v. Herman, 16 F. 812 (1883).

Where the preference is by actual delivery to the preferred creditors for the purpose of keeping it from passing to the assignee, the purpose of this section, which is equality among creditors, is defeated, and the courts are deprived of the means of enforcing its provisions. Doggett, Bassett & Hills Co. v. Herman, 16 F. 812 (1883).

Section does not invalidate bill of sale paying only part of debts if assignment act not relied upon. A bill of sale is not rendered invalid by the provisions of this section although it operates to transfer all of the debtor's property to a third party for the purpose of paying a portion only of his debts where it is apparent that the debtor did not intend to proceed under the assignment act or to take advantage of any of its provisions. Hayden v. Wellington, 63 F. 6 (8th Cir. 1894).

This section is not construed as prohibiting or interfering with the making of partial assignments; so far as the statute is concerned, such assignments are perfectly valid. Campbell v. Colo. Coal & Iron Co., 9 Colo. 60, 10 P. 248 (1885).

This section contains no provisions which can be held to preclude a citizen of this state from attaching the property of another citizen of the state, either at home or in a foreign jurisdiction, merely because the latter has become insolvent, and because such attachment may result in a preference. Schindelholz v. Cullum, 55 F. 885 (8th Cir. 1893).

Under the legislative enactment of 1881, had there been any attempt by the assignment to prefer creditors, such attempt would have been without effect to either prefer creditors, or to vitiate the deed, so as to defeat a ratable distribution of the proceeds of the entire estate among all the creditors. Campbell v. Colo. Coal & Iron Co., 9 Colo. 60, 10 P. 248 (1885); Ray v. Hiller, 11 Colo. 445, 18 P. 622 (1888).

Under the early statute, it was held that the fact that an insolvent debtor clearly attempted to evade this section by preferring certain creditors in separate transfers or instruments conveying portions of his property at or about the time he made a general assignment, if such fact was established, may be a reason for avoiding the preferences so given in a suit by or on behalf of injured creditors; but it was not a reason for declaring the assignment itself invalid. The assignment, this being the only objection thereto, might well be permitted to stand, and the property included be distributed ratably by the assignee among the creditors. Campbell v. Colo. Coal & Iron Co., 9 Colo. 60, 10 P. 248 (1885).

For early cases as to preferences, see Salsbury v. Ellison, 7 Colo. 167, 2 P. 906 (1883); Salsbury v. Ellison, 8 Colo. 157, 6 P. 217 (1884).

6-10-105. Assent of creditors presumed. When an assignment of property for the benefit of all the creditors of the assignor is made, the assent of the creditors shall be presumed.

Source: L. 1897: p. 95, § 5. **R.S. 08:** § 178. **C.L.** § 6245. **CSA:** C. 12, § 5. **CRS 53:** § 11-1-5. **C.R.S. 1963:** § 11-1-5.

ANNOTATION

Annotator's note. Cases material to § 6-10-105 decided prior to its earliest source, L. 1897, p. 95, § 5, have been included in the annotations to this section.

This section is simply declaratory of preexisting law. Spangler v. Sanborn, 7 Colo. App. 102, 43 P. 905 (1895).

Without it there would be the same presumption of the assent of the creditors. Spangler v. Sanborn, 7 Colo. App. 102, 43 P. 905 (1895).

The presumption of assent contemplated in this section obtains only in cases where no affirmative act on the part of the creditor evidences an intention to repudiate, or not to assent to, the assignment. Thatcher v. Valentine, 22 Colo. 201, 43 P. 1031 (1896).

It is a prima facie presumption merely that may be overcome by evidence to the contrary. Thatcher v. Valentine, 22 Colo. 201, 43 P. 1031 (1896).

So it is not compulsory upon a creditor to assent to an assignment made for his benefit in common with other creditors. Beifeld v. Martin, 4 Colo. App. 578, 37 P. 32 (1894).

His right to a proportionate share of the assets depends upon such assent. Beifeld v. Martin, 4 Colo. App. 578, 37 P. 32 (1894).

Creditor's refusal to assent may be inferred if he has knowledge of assignment. The

right of any creditor to participate in the benefits of the assignment depends upon his assent to such assignment, and his refusal to assent thereto may be inferred from his acts, but such inference can be drawn only from acts of the creditor done with the knowledge that an assignment had been made, or at least that it was in contemplation. Nat'l Bank of Commerce v. Graham, 16 Colo. App. 498, 66 P. 684 (1901).

Where one has no actual knowledge or notice of the execution of a deed of assignment, even though the deed is filed for record, it follows that one has no constructive notice of the execution of such deed. Nat'l Bank of Commerce v. Graham, 16 Colo. App. 498, 66 P. 684 (1901).

Moreover, this section does not prevent creditors from bringing action against the debtor or require those seeking to participate in the distribution of the estate to stipulate for his discharge. In re Carlson's for Music, Inc. v. Gould, 176 Colo. 172, 489 P.2d 1038 (1971).

6-10-106. Inventory filed where - bond. The assignee shall file with the clerk of the district court of the county in which such deed of assignment is recorded a true and complete inventory and valuation of the property of the said assignor, under oath, so far as the same has come to his knowledge, within a period not to exceed six days from the date of the filing of the deed of assignment; and shall make and file a bond to the state of Colorado, for the use of the creditors in double the amount of the inventory and valuation, with sureties to be approved by such clerk for the faithful performance of said trust and for a full and complete accounting for and of all property that may come into his hands as such assignee. Such assignee has no authority to sell or dispose of, or convert to the purposes of the trust any part of such estate, until he has complied with the provisions of this section.

Source: L. 1897: p. 95, § 6. **R.S. 08:** § 179. **C.L.** § 6246. **CSA:** C. 12, § 6. **CRS 53:** § 11-1-6. **C.R.S. 1963:** § 11-1-6. **L. 64:** p. 206, § 8.

ANNOTATION

The assignee after filing his bond, etc., as required by this section thereupon becomes an officer of the court. Flint v. Powell, 10 Colo. App. 66, 50 P. 45 (1897).

When the assignee does not file the inventory he is not an assignee and the deed to him is void. Kinney v. Yoelin Bros. Mercantile Co., 76 Colo. 136, 230 P. 127 (1924).

The assignee then becomes a mere agent with authority to sell, and his possession and acts are the possession and acts of his principal. Kinney v. Yoelin Bros. Mercantile Co., 76 Colo. 136, 230 P. 127 (1924).

Nonetheless, assignment is act of bankruptcy though assignee does not qualify. The fact that an assignee never qualified under the assignment or gave a bond as required by this section does not prevent the general assignment from being an act of bankruptcy. Moore v. Yampa Mercantile Co., 287 F. 629 (8th Cir. 1923).

6-10-107. Assignee an officer of court. An assignee named and qualified under this article shall be deemed to be an officer of court. Any interference with the assignee in the discharge of his duties is contempt of court, and no suit against the assignee in relation to or concerning the property assigned shall be instituted against the assignee without first obtaining permission of the court within and for the county in which the assignment is made.

Source: L. 1897: p. 95, § 7. **R.S. 08:** § 180. **C.L.** § 6247. **CSA:** C. 12, § 7. **CRS 53:** § 11-1-7. **C.R.S. 1963:** § 11-1-7.

ANNOTATION

An assignee is an officer of the court and responsible for an accounting to the court, the debtors, and the debtor's creditors. People v. Radinsky, 176 Colo. 357, 490 P.2d 951 (1971).

Subject to court supervision. The assignee is, in respect of the property in his hands, at all times subject to the order and supervision of the court or its judge. Taub v. McClelland-Colt Comm'n Co., 10 Colo. App. 190, 51 P. 168 (1897).

When and how an assignee may be proceeded against in relation to the property or its proceeds is in the discretion of the court, and there can be no interference with that dis-

cretion unless in case of its abuse. Taub v. McClelland-Colt Comm'n Co., 10 Colo. App. 190, 51 P. 168 (1897).

And where a creditor seizes property which a debtor has assigned to the court, the proper remedy is a citation for contempt under this section. In re Carlson's for Music, Inc. v. Gould, 176 Colo. 172, 489 P.2d 1038 (1971).

6-10-108. Notice of assignment of realty. Where real property or any interest therein is by deed conveyed to the assignee, the assignee shall forthwith file with the clerk and recorder of each county where the real estate is situated a notice of the assignment, containing the names of the assignor and assignee, the date of the deed of assignment, when and where recorded, and a description of the property in that county affected thereby, and the same shall be constructive notice to a purchaser or encumbrancer of the transfer of the property in said county, described in such notice.

Source: L. 1897: p. 96, § 8. **R.S. 08:** § 181. **C.L.** § 6248. **CSA:** C. 12, § 8. **CRS 53:** § 11-1-8. **C.R.S. 1963:** § 11-1-8.

ANNOTATION

Annotator's note. Cases material to § 6-10-108 decided prior to its earliest source, L. 1897, p. 96, § 8, have been included in the annotations to this section.

The method prescribed by this section must be pursued. Spangler v. Sanborn, 7 Colo. App. 102, 43 P. 905 (1895).

In the absence of the statutory notice, bona fide purchasers and encumbrancers will be protected. Spangler v. Sanborn, 7 Colo. App. 102, 43 P. 905 (1895).

Otherwise, title would vest upon delivery. The deed of the assignor, like the deed of any grantor, conveys the legal title to the property and would, but for this section, vest such title in the assignee upon its delivery. Thatcher v. Valentine, 22 Colo. 201, 43 P. 1031 (1896).

This section in making its record essential to vest title, as well as to constitute constructive notice, gives it the same, and no more, force than any other deed would have when recorded in the county wherein the real estate is situated. Thatcher v. Valentine, 22 Colo. 201, 43 P. 1031 (1896).

Hence, property situated in other counties, notwithstanding the title is vested in the assignee, is subject to sale and encumbrance until the notice prescribed is filed with the clerk and recorder of such counties. Thatcher v. Valentine, 22 Colo. 201, 43 P. 1031 (1896).

It conclusively follows, therefore, that the mere vesting of title in the assignee as to such property does not, ipso facto, place it in custodia legis. Thatcher v. Valentine, 22 Colo. 201, 43 P. 1031 (1896).

The word "encumbrancer" is employed in this section in its broad and general sense and embraces every class of encumbrancers and every class of encumbrances. Thatcher v. Valentine, 22 Colo. 201, 43 P. 1031 (1896).

Whether by contract or by statute. The encumbrance may be created by contract or it may be acquired in pursuance of some statute. Thatcher v. Valentine, 22 Colo. 201, 43 P. 1031 (1896).

Thus, a lien or charge upon land, which binds it for the payment of a debt, is an encumbrance, and the holder of the lien is an encumbrancer. Thatcher v. Valentine, 22 Colo. 201, 43 P. 1031 (1896).

Equal to mortgage. The lien of an attaching creditor is an encumbrance equally with a mortgage. Thatcher v. Valentine, 22 Colo. 201, 43 P. 1031 (1896).

6-10-109. Priority of claims - notice. The assignee shall forthwith give notice of such assignment by publication for four weeks in some newspaper in the county, if any, and if none, then in the nearest county thereto. The assignee shall also forthwith send a notice by mail to each creditor of whom he shall be informed, directed to his usual place of residence, stating the estimate of the aggregate value of all the property of the assignor, the estimate of the amount of his liabilities, and notifying each creditor to present his claim, under oath, to the assignee within three months from the mailing of such notice. It is the duty of each creditor to present his claim in the manner and within the time mentioned in the notice. Claims filed within the first three months shall have priority over those filed thereafter, unless a creditor can show, to the satisfaction of the court, that he never received the notice. Proof of notice by mail shall be made by affidavit by the assignee giving a list of creditors and the name of the post office where notice was sent within ten days after the mailing of

the same. Proof of the notice by publication shall be made by affidavit of the printer or publisher within ten days after the last publication or no fees shall be allowed the assignee for such notice by mail or publication.

Source: L. 1897: p. 96, § 9. **R.S. 08:** § 182. **C.L.** § 6249. **CSA:** C. 12, § 9. **CRS 53:** § 11-1-9. **C.R.S. 1963:** § 11-1-9.

Cross references: For clarification of publication terms, see § 24-70-106.

ANNOTATION

An assignee is an officer of the court and responsible for an accounting to the court, the debtors, and the debtor's creditors. People v. Radinsky, 176 Colo. 357, 490 P.2d 951 (1971).

However, creditor presumed to see notice. The published notice of the assignment may never fall under a particular creditor's observation, and he may therefore be without actual information of the fact; but the presumption is otherwise, and upon this presumption or constructive notice, the presumption of assent under § 6-10-105 is based. Spangler v. Sanborn, 7 Colo. App. 102, 43 P. 905 (1896).

Where it is obviously impossible that the required notice should have been given between the time of filing the deed for record and at the time of the levy of an attachment, with an attaching creditor having no knowledge or notice of the assignment, there is then, on his part, no assent in fact, and nothing from which the law would presume his assent. His levy is therefore not attended by the impediment of a presumptive assent, and is not invalidated by anything contained in § 6-10-105. Spangler v. Sanborn, 7 Colo. App. 102, 43 P. 905 (1896).

6-10-110. Report of assignee. At the expiration of three months from the time of the first publication and the mailing of notice, the assignee shall report and file with the clerk of the court a true and complete list, under oath, of all the creditors of the assignor who have filed their claims, the place of their residence, the amount claimed, and the amount and value, if any, of any security held by any such creditor. He shall also file a statement of all his proceedings with reference to the trust, showing what money has come into his hands and all the disbursements thereof.

Source: L. 1897: p. 97, § 10. **R.S. 08:** § 183. **C.L.** § 6250. **CSA:** C. 12, § 10. **CRS 53:** § 11-1-10. **C.R.S. 1963:** § 11-1-10.

ANNOTATION

An assignee is an officer of the court and responsible for an accounting to the court, the debtors, and the debtor's creditors. People v. Radinsky, 176 Colo. 357, 490 P.2d 951 (1971).

An assignee perpetrates a fraud by filing false documents upon the court. People v. Radinsky, 176 Colo. 357, 490 P.2d 951 (1971).

6-10-111. Exceptions to claims - hearing. Any person interested may appear before a dividend is made and file with the clerk any exceptions to the claim or demand of any creditor. The clerk shall immediately cause notice thereof to be given to the creditor which shall be served and returned as in the case of a summons. Within the time allowed to answer in an action at law, the creditor shall file his reply. The court shall designate the time for the hearing, and shall at such time hear the allegations and proof offered and shall render a just judgment thereon.

Source: L. 1897: p. 97, § 11. **R.S. 08:** § 184. **C.L.** § 6251. **CSA:** C. 12, § 11. **CRS 53:** § 11-1-11. **C.R.S. 1963:** § 11-1-11.

6-10-112. Judgment - fee of assignee. If no exception is made to a claim filed or if the claim has been favorably adjudicated, the court shall enter judgment in favor of the creditor and against the assignor for the amount claimed and found due, and order the assignee to make from time to time fair and equal dividends among the creditors, of the assets in his

hands, in proportion to their respective claims, and as soon as may be, to render a full account of said trust to the court. The court may allow such compensation or commissions, following as nearly as possible the compensation allowed executors for like services, as may be just and right.

Source: L. 1897: p. 97, § 12. **R.S. 08:** § 185. **C.L.** § 6252. **CSA:** C. 12, § 12. **CRS 53:** § 11-1-12. **C.R.S. 1963:** § 11-1-12.

ANNOTATION

An assignee violates his duties to the debtor and to the creditors of the debtor by charging the debtor service fees far in excess of those authorized by statute. People v. Radinsky, 176 Colo. 357, 490 P.2d 951 (1971).

6-10-113. Application of unclaimed dividends. The dividends of any unsettled assignment which remain unclaimed for such time as specified in this article after the final dividend has been decided, upon the application of one or more creditors of such assignor, shall be paid by the assignee under direction of the court to the known creditors of the assignor after giving notice to the creditors that a final distribution of all unclaimed dividends is to be made.

Source: L. 05: p. 155, § 1. **R.S. 08:** § 186. **C.L.** § 6253. **CSA:** C. 12, § 13. **CRS 53:** § 11-1-13. **C.R.S. 1963:** § 11-1-13.

6-10-114. Notice of distribution. Such notice shall be by advertisement in two or more local newspapers of general circulation and by written or printed notices mailed to the latest address of each creditor. The notice shall state that upon a certain day, not less than three months from the date of the notice, a final distribution of all the unclaimed dividends will be made to all creditors as can be found who have filed their respective claims with the assignee within the time specified by the notice for the filing of such claims. When the time for filing these claims has expired, the court, after deducting expenses of distribution, shall order the amount of the unclaimed dividends to be distributed pro rata among those creditors who have filed their claims for a share in the distribution of any unclaimed dividends in accordance with the provisions of this article.

Source: L. 05: p. 155, § 1. **R.S. 08:** § 187. **C.L.** § 6254. **CSA:** C. 12, § 12B. **CRS 53:** § 11-1-14. **C.R.S. 1963:** § 11-1-14.

6-10-115. Distribution of unclaimed dividends. Dividends remaining unclaimed for one year or longer after the final dividend has been declared by any assignee shall be distributed, under direction of the court, to the creditors whose claims have not been paid in full as provided in this article. If more than enough funds are on hand to pay these creditors in full, the balance shall be paid to the assignor.

Source: L. 05: p. 156, § 1. **R.S. 08:** § 188. **C.L.** § 6255. **CSA:** C. 12, § 12C. **CRS 53:** § 11-1-15. **C.R.S. 1963:** § 11-1-15.

6-10-116. Assignee under supervision of court. The assignee shall be subject to the order and supervision of the court at all times, and, by citation or attachment, may be compelled, from time to time, to file reports of his proceedings and the situation and condition of the trust and to proceed in the faithful execution of the duties required by this article, to keep correct books of account open to the inspection of the court or any person or his attorney interested in said estate. All conveyances of real estate and all sales of personal property by the assignee, not in the usual course of business, as conducted by the assignor, shall be approved by the court before such sale shall be valid.

Source: L. 1897: p. 98, § 13. **R.S. 08:** § 189. **C.L.** § 6256. **CSA:** C. 12, § 16. **CRS 53:** § 11-1-16. **C.R.S. 1963:** § 11-1-16.

ANNOTATION

An assignee is an officer of the court and responsible for an accounting to the court, the debtors, and the debtor's creditors. People v. Radinsky, 176 Colo. 357, 490 P.2d 951 (1971).

6-10-117. Assignee appointed by court - when. If the assignee named in the deed fails or neglects to file an inventory and valuation and give bond for the period of ten days after the making of any assignment, or if he dies before the closing of his trust, or is removed from the execution of the trust, the court upon the application of any person interested may appoint an assignee to execute such trust. Such appointee, when he has qualified as provided in this article, shall have all the rights, powers, and authority and be subject to the same restrictions and obligations as an original assignee.

Source: L. 1897: p. 98, § 14. **R.S. 08:** § 190. **C.L.** § 6257. **CSA:** C. 12, § 17. **CRS 53:** § 11-1-17. **C.R.S. 1963:** § 11-1-17.

ANNOTATION

An assignment does not by the refusal of the assignee to qualify fail to take effect or to vest the title to the property in trust in the assignee, placing that property and title within the jurisdiction of the state court to be administered by its subsequent appointee. Moore v. Yampa Mercantile Co., 287 F. 629 (8th Cir. 1923).

6-10-118. Removal of assignee by court. The court may remove the assignee for neglect in the execution of the trust, for fraud, for misapplying the trust, or wasting the estate, for failure to comply with the provisions of this article, or to obey the orders of, or to submit to the supervision of the court, or for any other good cause shown. The assignee may also be removed upon the petition of the majority in number and value of the creditors, unless the court is satisfied that such removal would not be for the best interest of the trust estate.

Source: L. 1897: p. 98, § 15. **R.S. 08:** § 191. **C.L.** § 6258. **CSA:** C. 12, § 18. **CRS 53:** § 11-1-18. **C.R.S. 1963:** § 11-1-18.

6-10-119. Powers of assignee. The assignee has all the rights, power, and authority of the assignor necessary to fully execute such trust, to demand and sue for any property belonging to such estate, and to execute valid receipts; and, by deed duly acknowledged by him, in his own name as assignee, may convey any of the estate, real and personal, subject to approval as stated in section 6-10-116. Where the assignee has been appointed by the court in place of an assignee removed, it shall be his duty to compel by suit, or the peremptory order of the court, the delivery of the trust estate and the property, or the value thereof, that has been wasted or misapplied by the previous assignee.

Source: L. 1897: p. 98, § 16. **R.S. 08:** § 192. **C.L.** § 6259. **CSA:** C. 12, § 19. **CRS 53:** § 11-1-19. **C.R.S. 1963:** § 11-1-19.

ANNOTATION

Annotator's note. Cases material to § 6-10-119 decided prior to its earliest source, L. 1897, p. 98, § 16, have been included in the annotations to this section.

The assignee stands in the shoes of his assignor, and whatever claim in respect to the property one might have against the latter, can also be asserted against the former. Taub v.

McClelland-Colt Comm'n Co., 10 Colo. App. 190, 51 P. 168 (1897).

The authority of the assignee is derived from the statute and not from the instrument of assignment. Falk v. Liebes, 6 Colo. App. 473, 42 P. 46 (1895).

Therefore, the powers which an assignor may assume to grant by his deed are without effect; if they are in accord with those conferred by the statute, they are superfluous, if not, they are void. Falk v. Liebes, 6 Colo. App. 473, 42 P. 46 (1895).

Whenever an estate passes to an assignee for distribution among creditors, the assignee is not obligated to accept assets which will prove onerous to the estate and a burden rather than an asset. Hill v. Graham, 11 Colo. App. 536, 53 P. 1060 (1898).

Creditors may compel assignee to pursue course, as to property, for best interest of all. If the assignee should attempt to accept assets which would prove a burden rather than an advantage, the creditors would not be without remedy and they might apply to the court having original jurisdiction in the matter to compel him to take the course which was for the best interests of the creditors generally. Hill v. Graham, 11 Colo. App. 536, 53 P. 1060 (1898).

The assignee is the only person after the assignment who can attack the validity of a chattel mortgage. Clark v. Bright, 30 Colo. 199, 69 P. 506 (1902).

At common law an assignee took only that interest which the debtor had at the time of the assignment. From this it follows that property previously conveyed, though in fraud of creditors, did not pass, and the creditors, not the assignee, were the ones to sue to set it aside. Wells v. Schuster-Hax Nat'l Bank, 23 Colo. 534, 48 P. 809 (1897).

6-10-120. Insufficient sureties. If it is shown to the court at any time that the sureties on the assignee's bond are not sufficient, the court may order sufficient sureties to be given, and may compel obedience thereto by removal or otherwise.

Source: L. 1897: p. 99, § 17. **R.S. 08:** § 193. **C.L.** § 6260. **CSA:** C. 12, § 20. **CRS 53:** § 11-1-20. **C.R.S. 1963:** § 11-1-20.

6-10-121. Additional security - when. The assignee, from time to time, shall file with the clerk of the court an inventory and valuation of any additional property which may come into his hands after the first inventory; and the judge, or, in his absence, the clerk, may thereupon require the assignee to give additional security.

Source: L. 1897: p. 99, § 18. **R.S. 08:** § 194. **C.L.** § 6261. **CSA:** C. 12, § 21. **CRS 53:** § 11-1-21. **C.R.S. 1963:** § 11-1-21.

6-10-122. Appearance compelled - when. The court, upon the application of the assignee, or of any creditor, may compel the appearance in person of the debtor, or any other witness, before the court, or a commissioner appointed by the court, at any time designated, to answer under oath such matters as may be inquired of him. Such debtor or other witness may then be fully examined under oath as to the amount and situation of his property, the payments and conveyances made by him, and the names and places of residence of creditors and the amounts due to each. The court, upon like application, may compel the debtor to deliver to the assignee any property or estate embraced in the assignment.

Source: L. 1897: p. 99, § 19. **R.S. 08:** § 195. **C.L.** § 6262. **CSA:** C. 12, § 22. **CRS 53:** § 11-1-22. **C.R.S. 1963:** § 11-1-22.

6-10-123. Misappropriation by debtor. No assignment shall be invalid because of misappropriation of the property of the debtor by him prior to the assignment, but the assignee may recover such property, if so misappropriated in fraud of this article. Nothing in this article shall invalidate any conveyance or mortgage of property, real or personal, by the debtor before the assignment, made in good faith, for a valid and valuable consideration.

Source: L. 1897: p. 100, § 20. **R.S. 08:** § 196. **C.L.** § 6263. **CSA:** C. 12, § 23. **CRS 53:** § 11-1-23. **C.R.S. 1963:** § 11-1-23.

ANNOTATION

Annotator's note. Cases material to § 6-10-123 decided prior to its earliest source, L. 1897, p. 100, § 20, have been included in the annotations to this section.

Where property has been misappropriated the right of action, if any, inures to the assignee who might bring such suit to recover it as circumstances warranted. Bailey v. Am. Nat'l Bank, 12 Colo. App. 66, 54 P. 912 (1898).

To vitiate an assignment under this section there must be fraudulent intention followed by irregular and fraudulent disposition of the property or a failure to convey all. In other words, there must be either a reservation of property or such a disposition of it that the proceeds will inure in some way to the benefit of the assignor. Hunter v. Ferguson, 3 Colo. App. 287, 33 P. 82 (1893).

However, a general assignment by a debtor of all his property for the benefit of all his creditors is not a fraudulent disposition of property furnishing ground for an attachment when it is made honestly and bona fide. Hunter v. Ferguson, 3 Colo. App. 287, 33 P. 82 (1893).

Any debtor, whether insolvent or otherwise, so long as he remains in possession of his property with full power of disposition, may mortgage and incumber his property for the benefit of his creditors even though the result may be that some creditors thereby obtain a preference as against the general creditors of the insolvent. Bailey v. Am. Nat'l Bank, 12 Colo. App. 66, 54 P. 912 (1898).

Moreover, this section plainly recognizes the right of a debtor to prefer by payment or security, and clearly affirms the right of a debtor to do with his property as he pleases except as in terms restrained by statute. May v. Tenney, 148 U.S. 60, 13 S. Ct. 491, 37 L. Ed. 368 (1893).

6-10-124. Debts not due - interest. Debts not due may be claimed, but if the same are not bearing interest, a suitable rebate shall be made. Interest shall be computed to the date of the assignment and not afterwards.

Source: L. 1897: p. 100, § 21. **R.S. 08:** § 197. **C.L.** § 6264. **CSA:** C. 12, § 24. **CRS 53:** § 11-1-24. **C.R.S. 1963:** § 11-1-24.

ANNOTATION

Law reviews. For article, "An Update of Appendices from Collecting Pre- and Post-Judgment Interest in Colorado", see 15 Colo. Law. 990 (1986).

6-10-125. Creditors may appoint an attorney. The majority in number and value of the creditors may appoint, in writing, an attorney-at-law to represent the estate before the court. The attorney, if appointed, shall examine all reports and inventories and books of the assignee and inquire fully as to the conduct of the assignee in the discharge of his trust. He may appear for the assignee in all suits in behalf of the assignee in securing, preserving, or defending the estate, but shall appear in behalf of the creditors in all suits, examinations, or inquiries as to the accounts or the conduct of the assignee concerning the estate. The court may allow such compensation to the attorney as may be just and reasonable.

Source: L. 1897: p. 100, § 22. **R.S. 08:** § 198. **C.L.** § 6265. **CSA:** C. 12, § 25. **CRS 53:** § 11-1-25. **C.R.S. 1963:** § 11-1-25.

6-10-126. Waiver of proceedings by parties. At any time after an assignment has been made, the assignor, the creditors, and the assignee of such assignor may agree in writing that all proceedings to be had before the court under the provisions of this article, may be waived. Upon the filing of such agreement with the clerk of the proper court, the court shall cease to have any further jurisdiction over such assignment and the proceedings thereunder, and the assignee shall no longer be held accountable to the court. The creditors and the assignee, with the consent of the assignor, in writing, may make such disposition of the assigned estate and arrangements in reference thereto as to them shall seem proper in the premises.

Source: L. 1897: p. 100, § 23. **R.S. 08:** § 199. **C.L.** § 6266. **CSA:** C. 12, § 12. **CRS 53:** § 11-1-26. **C.R.S. 1963:** § 11-1-26.

6-10-127. Final report - notice - discharge. (Repealed)

Source: L. 1897: p. 101, § 24. **R.S. 08:** § 200. **C.L.** § 6267. **CSA:** C. 12, § 27. **CRS 53:** § 11-1-27. **C.R.S. 1963:** § 11-1-27. **L. 78:** Entire section repealed, p. 253, § 5, effective May 23.

6-10-128. Trust closed in one year. The assignee shall close his trust within one year from the filing of the deed of assignment unless the court for good cause shown, extends the time.

Source: L. 1897: p. 101, § 25. **R.S. 08:** § 201. **C.L.** § 6268. **CSA:** C. 12, § 28. **CRS 53:** § 11-1-28. **C.R.S. 1963:** § 11-1-28.

6-10-129. Property exempt from assignment. No deed of assignment shall be invalid which excepts from the operation thereof the property which by law is not subject to levy and sale under execution.

Source: L. 1897: p. 101, § 26. **R.S. 08:** § 202. **C.L.** § 6269. **CSA:** C. 12, § 29. **CRS 53:** § 11-1-29. **C.R.S. 1963:** § 11-1-29.

ANNOTATION

The exception in a deed of property exempt by law from execution is permitted under this section. Falk v. Liebes, 6 Colo. App. 473, 42 P. 46 (1895) (decided prior to earliest source of this section, L. 1897, p. 101, § 26).

6-10-130. Preferred claims. The valid claims of servants, laborers, and employees of the assignor, for wages earned during the six months immediately preceding the date of the assignment, not to exceed fifty dollars, to any one person then unpaid, which claims are still held by the person who earned them, and all taxes assessed under the laws of this state, or of the United States, are preferred claims and shall be paid in full prior to the payment of the dividends in favor of other creditors.

Source: L. 1897: p. 101, § 27. **R.S. 08:** § 203. **C.L.** § 6270. **CSA:** C. 12, § 30. **CRS 53:** § 11-1-30. **C.R.S. 1963:** § 11-1-30.

ANNOTATION

A provision in a deed of assignment for the payment of preferred debts is unnecessary. Falk v. Liebes, 6 Colo. App. 473, 42 P. 46 (1895) (decided prior to earliest source of this section, L. 1897, p. 101, § 27).

6-10-131. Action on bond of assignee. Any creditor may maintain an action on the bond of the assignee, for any damages such creditor may have sustained, by reason of assignee's acts or his failure to act.

Source: L. 1897: p. 101, § 28. **R.S. 08:** § 204. **C.L.** § 6271. **CSA:** C. 12, § 31. **CRS 53:** § 11-1-31. **C.R.S. 1963:** § 11-1-31.

6-10-132. Foreclosure of mortgage on property. No mortgage, deed of trust, or other security, real or personal, securing the payment of claims against the assigned estate shall be foreclosed within one year from the making of the assignment except upon order of court. No such mortgage, deed of trust, or other security shall be foreclosed except by suit, unless the claim secured is first proved and allowed by such court. When such claim is so proved and allowed, the court may order a foreclosure of the mortgage, deed of trust, or

other security within one year from the making of the assignment. The lien of the mortgage, trust deed, or other security affected by this article shall not be impaired by the suspension of the remedy provided in this section.

Source: L. 1897: p. 101, § 29. **R.S. 08:** § 205. **C.L.** § 6272. **CSA:** C. 12, § 32. **CRS 53:** § 11-1-32. **C.R.S. 1963:** § 11-1-32.

6-10-133. Effect of general assignment. (Repealed)

Source: L. 1897: p. 102, § 30. **R.S. 08:** § 206. **C.L.** § 6273. **CSA:** C. 12, § 33. **CRS 53:** § 11-1-33. **C.R.S. 1963:** § 11-1-33. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-134. Application of assignor for discharge. (Repealed)

Source: L. 1897: p. 102, § 31. **R.S. 08:** § 207. **C.L.** § 6274. **CSA:** C. 12, § 34. **CRS 53:** § 11-1-34. **C.R.S. 1963:** § 11-1-34. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-135. Form of affidavit annexed to application. (Repealed)

Source: L. 1897: p. 103, § 32. **R.S. 08:** § 208. **C.L.** § 6275. **CSA:** C. 12, § 35. **CRS 53:** § 11-1-35. **C.R.S. 1963:** § 11-1-35. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-136. Order to show cause - when. (Repealed)

Source: L. 1897: p. 104, § 33. **R.S. 08:** § 209. **C.L.** § 6276. **CSA:** C. 12, § 36. **CRS 53:** § 11-1-36. **C.R.S. 1963:** § 11-1-36. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-137. Hearing - proof of notice - issues. (Repealed)

Source: L. 1897: p. 105, § 34. **R.S. 08:** § 210. **C.L.** § 6277. **CSA:** C. 12, § 37. **CRS 53:** § 11-1-37. **C.R.S. 1963:** § 11-1-37. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-138. Jury trial - when. (Repealed)

Source: L. 1897: p. 105, § 35. **R.S. 08:** § 211. **C.L.** § 6278. **CSA:** C. 12, § 38. **CRS 53:** § 11-1-38. **C.R.S. 1963:** § 11-1-38. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-139. Jury drawn as in civil cases. (Repealed)

Source: L. 1897: p. 106, § 36. **R.S. 08:** § 212. **C.L.** § 6279. **CSA:** C. 12, § 39. **CRS 53:** § 11-1-39. **C.R.S. 1963:** § 11-1-39. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-140. Verdict recorded - costs. (Repealed)

Source: L. 1897: p. 106, § 37. **R.S. 08:** § 213. **C.L.** § 6280. **CSA:** C. 12, § 40. **CRS 53:** § 11-1-40. **C.R.S. 1963:** § 11-1-40. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-141. Court decides if jury disagrees. (Repealed)

Source: L. 1897: p. 106, § 38. **R.S. 08:** § 214. **C.L.** § 6281. **CSA:** C. 12, § 41. **CRS 53:** § 11-1-41. **C.R.S. 1963:** § 11-1-41. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-142. Evidence at hearing. (Repealed)

Source: L. 1897: p. 106, § 39. **R.S. 08:** § 215. **C.L.** § 6282. **CSA:** C. 12, § 42. **CRS 53:** § 11-1-42. **C.R.S. 1963:** § 11-1-42. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-143. Jurisdiction of creditors - when. (Repealed)

Source: L. 1897: p. 106, § 40. **R.S. 08:** § 216. **C.L.** § 6283. **CSA:** C. 12, § 43. **CRS 53:** § 11-1-43. **C.R.S. 1963:** § 11-1-43. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-144. Discharge of assignor - when. (Repealed)

Source: L. 1897: p. 107, § 41. **R.S. 08:** § 217. **C.L.** § 6284. **CSA:** C. 12, § 44. **CRS 53:** § 11-1-44. **C.R.S. 1963:** § 11-1-44. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-145. Discharge - qualifications - exceptions. (Repealed)

Source: L. 1897: p. 107, § 41. **R.S. 08:** § 217. **C.L.** § 6284. **CSA:** C. 12, § 44. **CRS 53:** § 11-1-45. **C.R.S. 1963:** § 11-1-45. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-146. Judgment upon discharge - release. (Repealed)

Source: L. 1897: p. 108, § 42. **R.S. 08:** § 218. **C.L.** § 6285. **CSA:** C. 12, § 45. **CRS 53:** § 11-1-46. **C.R.S. 1963:** § 11-1-46. **L. 67:** p. 992, §§ 2, 4. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-147. Discharge bars subsequent action. (Repealed)

Source: L. 1897: p. 109, § 43. **R.S. 08:** § 219. **C.L.** § 6286. **CSA:** C. 12, § 46. **CRS 53:** § 11-1-47. **C.R.S. 1963:** § 11-1-47. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-148. Appeal - bond. (Repealed)

Source: L. 1897: p. 109, § 44. **R.S. 08:** § 220. **C.L.** § 6287. **CSA:** C. 12, § 47. **CRS 53:** § 11-1-48. **C.R.S. 1963:** § 11-1-48. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-149. Joint debtor not released. (Repealed)

Source: L. 1897: p. 110, § 45. **R.S. 08:** § 221. **C.L.** § 6288. **CSA:** C. 12, § 48. **CRS 53:** § 11-1-49. **C.R.S. 1963:** § 11-1-49. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-150. Property not affected. (Repealed)

Source: L. 1897: p. 110, § 46. **R.S. 08:** § 222. **C.L.** § 6289. **CSA:** C. 12, § 49. **CRS 53:** § 11-1-50. **C.R.S. 1963:** § 11-1-50. **L. 77:** Entire section repealed, p. 292, § 1, effective May 26.

6-10-151. Jurisdiction of district court. The district court in the proper county has jurisdiction in the matter of assignments and petitions for discharge under this article.

Source: L. 1897: p. 110, § 47. **R.S. 08:** § 223. **C.L.** § 6290. **CSA:** C. 12, § 50. **CRS 53:** § 11-1-51. **C.R.S. 1963:** § 11-1-51. **L. 64:** p. 206, § 9.

6-10-152. Colorado rules of civil procedure apply. The provisions of the Colorado rules of civil procedure shall be applicable, except as otherwise provided in this article, and shall control in all proceedings under this article.

Source: L. 1897: p. 110, § 49. **R.S. 08:** § 225. **C.L.** § 6292. **CSA:** C. 12, § 52. **CRS 53:** § 11-1-53. **C.R.S. 1963:** § 11-1-53.

6-10-153. Property under jurisdiction of court. In all assignments for the benefit of creditors made in this state, the district court in and for the county in which such deed of assignment is recorded as now provided by law has full power and complete jurisdiction over all the property, real, personal, and mixed, conveyed by such assignment from the date of the making of the same. The court may make any order in reference to any part or all of the property embraced in the estate and the disposition thereof by the assignee which to the court seems just and equitable, and all such orders shall be legal and binding upon the assignor, the assignee, and creditors of the estate whether or not any notice is given of the application therefor or the order so made; except that the court may in its discretion require notice of such an application so made to be given in reference to any matter that may come before it for hearing, and in such case it shall direct, by an order, the form and manner of giving such notice so required by it.

Source: L. 1897: p. 111, § 1. **R.S. 08:** § 226. **C.L.** § 6293. **CSA:** C. 12, § 53. **CRS 53:** § 11-1-54. **C.R.S. 1963:** § 11-1-54. **L. 64:** p. 207, § 10.

ANNOTATION

Matters are within control of court. Claims are filed and are allowed or exceptions are taken, and the validity or invalidity of claims as between the assignees and claimants, or as between creditors, the payment of dividends, and all other matters relating to the winding up of such estates are entirely under the control and direction of the court like any other litigation. Hill v. Graham, 11 Colo. App. 536, 53 P. 1060 (1898).

Court cannot except valuable parts of debtor's property. Where a grantor deliberately conveys his property without exception or reservation for the benefit of his creditors, it is not the province of the court to except therefrom valuable parts of his property. Moore v. Yampa Mercantile Co., 287 F. 629 (8th Cir. 1923).

One who interferes with property without permission of the court in whose custody it is is guilty of contempt. In re Carlson's for Music, Inc. v. Gould, 176 Colo. 172, 489 P.2d 1038 (1971).

6-10-154. Disposition of property when no market. When any difficulty is encountered by the assignee in converting the assigned property of any assignment, or any part thereof, into cash on account of there being no sufficient market therefor, or for any other good reason, the court may direct by such order as described in section 6-10-153 the distribution of such property in kind among the creditors electing to take property. Creditors not electing to take property shall be paid an equal pro rata in cash, fixing by appraisement or sworn evidence in courts such price or value upon each piece, parcel, or item of property

as shall make it bear and pay its proportion of the entire indebtedness of the estate, and as shall be just and equitable between the assignor and the creditors and all persons interested in the assigned estate. When the court authorizes the assignee to exchange such property in payment of the proved indebtedness of the estate at the prices so fixed, and when, in the opinion of the court, the best interests of the estate are promoted thereby, it may order the assignee to first offer such property at public auction; and, in that case, it shall provide by its order the kind and form of notice to be given of such sale. The assignee at such sale shall offer and sell the property to the highest and best bidder therefor in proved accounts against the estate, and he shall not accept any bid lower than the price fixed by the court on the property so offered.

Source: L. 1897: p. 112, § 2. **R.S. 08:** § 227. **C.L.** § 6294. **CSA:** C. 12, § 54. **CRS 53:** § 11-1-55. **C.R.S. 1963:** § 11-1-55.

ENFORCEMENT OF NONDRAMATIC MUSIC COPYRIGHTS

ARTICLE 13

Enforcement of Music Copyrights

6-13-101. Definitions. As used in this article, unless the context otherwise requires:

(1) "Copyright owner" means the owner of a copyright of a nondramatic musical or similar work recognized and enforceable under the copyright laws of the United States (17 U.S.C. sec. 101 et seq.). "Copyright owner" and "similar work" shall not include the owner of a copyright in a motion picture or audiovisual work, or in part of a motion picture or audiovisual work.

(2) "Nondramatic" means the public performance of a recorded, broadcast, or live musical work; except that "nondramatic" shall not mean the performance of a dramatic work including a play.

(3) "Performing rights society" means an association or corporation that licenses the public performance of nondramatic musical works on behalf of copyright owners such as the American society of composers, authors and publishers (ASCAP), Broadcast Music, Inc. (BMI), and SESAC, Inc.

(4) "Proprietor" means the owner of a retail establishment, including, but not limited to, a restaurant, bar, sports facility, or other place of business where nondramatic musical or similar copyrighted works may be performed, broadcast, or otherwise transmitted for the enjoyment of members of the general public.

(5) "Royalty" or "royalties" means the fees payable to a copyright owner or performing rights society for the public performance of nondramatic musical or other similar work.

Source: L. 95: Entire article added, p. 1263, § 1, effective July 1.

6-13-102. Scope of article. (1) This article shall apply to a contract entered into between a performing rights society and a proprietor even if such society is licensed by the federal communications commission, and the rights, remedies, and prohibitions accorded by this article shall be in addition to any other right, remedy, or prohibition accorded by common law, federal law, or the laws of this state, and shall not be construed to deny, abrogate, or impair any such common law or statutory right, remedy, or prohibition.

(2) This article shall not apply to:

(a) A contract entered into between a performing rights society and a broadcaster licensed by the federal communications commission;

(b) Conduct described in sections 18-4-602, 18-4-603, and 18-4-604, C.R.S.

Source: L. 95: Entire article added, p. 1264, § 1, effective July 1.

6-13-103. Payment of royalties - contract requirements. (1) A copyright owner or performing rights society may enter into a contract requiring the payment of royalties by a proprietor if, at least seventy-two hours before the execution of such contract, the following information is provided to the proprietor, in writing:

(a) A description of the rules and terms of royalties required to be paid under the contract;

(b) A schedule of the rates and a description of the terms of royalties required to be paid under agreements executed by the copyright owner or performing rights society;

(c) In the case of a performing rights society, information concerning how to obtain a current list of the copyright owners represented by that society and the works licensed under the contract. Such list shall be made available within fourteen days by electronic means. A proprietor shall not be charged an amount in excess of the actual cost incurred by the performing rights society for providing such list.

(d) Notice, in a form prescribed by the attorney general, that the proprietor is entitled to the information contained in paragraphs (a), (b), and (c) of this subsection (1), and that the failure to provide such information shall make the performing rights society subject to the penalty provisions in section 6-13-104.

(2) Notwithstanding subsection (1) of this section, a proprietor may, in its sole discretion and without coercion or undue influence, execute a contract for the payment of royalties before the expiration of the seventy-two hour review period.

(3) A proprietor shall have the right to rescind a contract for the payment of royalties for a period of seventy-two hours after execution of such contract.

(4) A contract for the payment of the royalties by a proprietor to a copyright owner or society shall:

(a) Be in writing;

(b) Be signed by the parties;

(c) Include at least the following information:

(I) The proprietor's name and business address and the name and location of each place of business to which the contract applies;

(II) The name and address of the performing rights society authorized to act on behalf of a copyright owner;

(III) The duration of the contract, which shall not exceed one year, but which may be automatically extended for additional terms which do not exceed one year, unless otherwise mutually agreed upon;

(IV) The schedule of rates and terms of royalties to be collected under the contract, including any sliding scale or schedule for any increase or decrease of such rates for the duration of the contract;

(V) Notice of the seventy-two-hour rescission period described in subsection (3) of this section.

(5) A copyright owner, performing rights society, or an agent or employee of a copyright owner or performing rights society shall not:

(a) Enter onto the premises of a proprietor's business for the purpose of discussing with the proprietor or the employees of the proprietor a contract for the payment of royalties or the use of copyrighted works without first identifying himself or herself to the proprietor or the employees of the proprietor and making known the purpose of the visit;

(b) Collect or attempt to collect a royalty payment or other fee pursuant to a contract that does not meet the requirements of this section;

(c) Engage in any coercive conduct or unfair or deceptive act or practice that is substantially disruptive of a proprietor's business;

(d) Use or attempt to use any unfair or deceptive act or practice in negotiating with a proprietor.

(6) Nothing in this article shall be construed to prohibit a performing rights society from conducting investigations to determine the existence of music use by a proprietor or informing a proprietor of the proprietor's obligations under the copyright laws of the United States (17 U.S.C. sec. 101 et seq.).

Source: L. 95: Entire article added, p. 1264, § 1, effective July 1.

6-13-104. Violations - penalties. (1) A proprietor may bring an action in a court of competent jurisdiction or assert a counterclaim against a copyright owner or performing rights society to enjoin a violation of this article and recover any damages sustained as a result of such violation.

(2) The prevailing party in any action brought under this article shall be awarded reasonable attorney fees. If the prevailing party is a proprietor, such proprietor may also recover the reasonable costs of such action and treble damages, but in no event shall such proprietor be awarded less than one thousand dollars.

(3) A proprietor shall not bring a counterclaim against any party except the original complainant, and if such complainant is a performing rights society, a counterclaim shall not be brought against any copyright owner in his or her individual capacity.

Source: L. 95: Entire article added, p. 1266, § 1, effective July 1.

CONSIGNMENTS OF ART

ARTICLE 15

Consignment of Works of Fine Art

6-15-101. Definitions. As used in this article, unless the context otherwise requires:

(1) "Art dealer" means a person engaged in the business of selling works of fine art, other than a person exclusively engaged in the business of selling goods at public auction.

(2) "Artist" means the creator of a work of fine art.

(3) "On consignment" means that no title to or estate in the goods or right to possession thereof superior to that of the consignor vests in the consignee, notwithstanding the consignee's power or authority to transfer and convey all of the right, title, and interest of the consignor, in and to such goods to a third person.

(4) "Work of fine art" or "work" means:

(a) A work of visual art such as a painting, sculpture, drawing, mosaic, or photograph;

(b) A work of calligraphy;

(c) A work of graphic art such as an etching, a lithograph, an offset print, a silk screen, or any other work of similar nature;

(d) A craft work in materials, including but not limited to clay, textile, fiber, wood, metal, plastic, or glass;

(e) A work in mixed media such as collage or any combination of the art media set forth in this subsection (4).

Source: L. 82: Entire article added, p. 229, § 1, effective March 25.

6-15-102. Art dealers and artists - consignment of works of fine art. (1) Notwithstanding any custom, practice, or usage of the trade and any of the provisions of section 4-2-326, C.R.S., to the contrary, whenever an artist delivers or causes to be delivered a work of fine art of his own creation to an art dealer for the purpose of exhibition or sale on a

commission, fee, or other basis of compensation, the delivery to and acceptance thereof by the art dealer is deemed to place the work on consignment and:

(a) Such art dealer shall thereafter, with respect to the work, be deemed to be the agent of such artist;

(b) Such work is trust property in the hands of the consignee for the benefit of the consignor; and

(c) Any proceeds from the sale of the work are trust funds in the hands of the consignee for the benefit of the consignor.

(2) Notwithstanding the subsequent purchase of a work of fine art by the consignee directly or indirectly for his own account, the work initially received on consignment shall be deemed to remain trust property until the price is paid in full to the consignor. If such work is thereafter resold to a bona fide third party before the consignor has been paid in full, the proceeds of the resale are trust funds in the hands of the consignee for the benefit of the consignor to the extent necessary to pay any balance still due to the consignor, and such trusteeship shall continue until the fiduciary obligation of the consignee with respect to such transaction is discharged in full.

(3) Notwithstanding the provisions of the "Uniform Commercial Code - Sales", no such trust property or trust funds shall be subject to or subordinate to any claims, liens, or security interests of the consignee's creditors.

(4) An art dealer is strictly liable for the loss of or damage to a work of fine art while it is in his possession. The value of the work of fine art is, for the purposes of this subsection (4), the value established in a written agreement between the artist and the art dealer prior to the loss or damage of the work.

Source: L. 82: Entire article added, p. 230, § 1, effective March 25. **L. 95:** (4) amended, p. 192, § 2, effective April 13.

Editor's note: Changes in the internal numbering and lettering of subsection (1) were made on revision in 1998 to conform to standard C.R.S. format.

Cross references: For the provisions in the "Uniform Commercial Code" concerning sales, see article 2 of title 4.

6-15-103. Penalties. A violation by an art dealer of any of the provisions of this article shall render the art dealer liable for damages to the artist in an amount equal to fifty dollars plus the actual damages sustained by the artist, including incidental and consequential damages. In such an action reasonable attorney fees and court costs shall be paid to the prevailing party.

Source: L. 82: Entire article added, p. 230, § 1, effective March 25.

6-15-104. Applicability. (1) This article shall not apply to any contract or arrangement in existence prior to March 25, 1982, nor to any extensions or renewals thereof; except that the parties to such contract or arrangement may thereafter elect to be governed by the provisions of this article.

(2) Any provision, whether oral or written, in or pertaining to the placing of a work of fine art on consignment whereby any provision of this article is waived shall be deemed to be against public policy and shall be void.

Source: L. 82: Entire article added, p. 230, § 1, effective March 25.

CHARITABLE SOLICITATIONS

ARTICLE 16

Colorado Charitable Solicitations Act

6-16-101. Short title. This article shall be known and may be cited as the "Colorado Charitable Solicitations Act".

Source: L. 88: Entire article added, p. 350, § 1, effective July 1.

ANNOTATION

Law reviews. For article, "A Survey of the Law of Colorado Nonprofit Entities", see 27 Colo. Law. 5 (April 1998).

6-16-102. Legislative declaration. The general assembly hereby finds that fraudulent charitable solicitations are a widespread practice in this state that results in millions of dollars of losses to contributors and legitimate charities each year. Legitimate charities are harmed by such fraud because the money available for contributions continually is being siphoned off by fraudulent charities, and the goodwill and confidence of contributors continually is being undermined by the practices of unscrupulous solicitors. The general assembly further finds that legitimate charities provide many public benefits and that charitable donations are a direct result of public trust in charities. The general assembly therefore finds that the provisions of this article, including those involving pertinent information to be filed in a timely manner by charitable organizations and disclosures to be made by paid solicitors, are necessary to protect the public's interest in making informed choices as to which charitable causes should be supported. Furthermore, these provisions are intended to help the secretary of state investigate allegations of wrongdoing in charities, without having a chilling effect on donors who wish to give anonymously or requiring public disclosure of confidential information about charities.

Source: L. 88: Entire article added, p. 350, § 1, effective July 1. **L. 2008:** Entire section amended, p. 806, § 1, effective September 1.

6-16-103. Definitions. As used in this article, unless the context otherwise requires:

(1) "Charitable organization" means any person who is or holds himself out to be established for any benevolent, educational, philanthropic, humane, scientific, patriotic, social welfare or advocacy, public health, environmental conservation, civic, or other eleemosynary purpose, any person who operates for the benefit of the objectives of law

enforcement officers, firefighters, other persons who protect the public safety, or veterans, or any person who in any manner employs a charitable appeal or an appeal which suggests that there is a charitable purpose as the basis for any solicitation. "Charitable organization" does not include the department of revenue collecting voluntary contributions for organ and tissue donations under the provisions of sections 42-2-107 (4) (b) (V) and 42-2-118 (1) (a) (II), C.R.S.

(2) "Charitable purpose" means any benevolent, educational, philanthropic, humane, scientific, patriotic, social welfare or advocacy, public health, environmental conservation, civic, or other eleemosynary purpose, any objective of law enforcement officers, firefighters, other persons who protect the public safety, or veterans, or any objective of sponsoring the free or subsidized attendance of persons at any event.

(3) "Charitable sales promotion" means an advertising or sales campaign which is conducted by a commercial coventurer and which represents that the purchase or use of goods or services offered by the commercial coventurer will benefit, in whole or in part, a charitable organization or purpose.

(4) "Commercial coventurer" means a person who, for profit, is regularly and primarily engaged in trade or commerce other than in connection with soliciting for charitable organizations or purposes and who conducts a charitable sales promotion.

(5) "Contribution" means the grant, promise, or pledge of money, credit, property, financial assistance, or any other thing of value in response to a solicitation. "Contribution" does not include voluntary contributions for organ and tissue donations under the provisions of sections 42-2-107 (4) (b) (V) and 42-2-118 (1) (a) (II), C.R.S., and bona fide fees, dues, or assessments paid by members of a charitable organization if membership is not conferred primarily as consideration for making a contribution in response to a solicitation.

(6) Repealed.

(7) "Paid solicitor" means a person who, for monetary compensation, performs any service in which contributions will be solicited in this state by such compensated person or by any compensated person he or she employs, procures, or engages, directly or indirectly, to solicit for contributions. The following persons are not "paid solicitors":

(a) A person whose sole responsibility is to print or mail fund-raising literature;

(b) A lawyer, investment counselor, or banker who renders professional services to a charitable organization or advises a person to make a charitable contribution during the course of rendering such professional services or advice to the charitable organization or person;

(c) A bona fide volunteer;

(d) A director, officer, or compensated employee who is directly employed by a charitable organization which, at the time of the solicitation, had received a determination letter from the internal revenue service granting the organization tax-exempt status pursuant to 26 U.S.C. sec. 501 (c) (3), (c) (4), (c) (8), (c) (10), or (c) (19). For purposes of this paragraph (d), such a determination letter shall not have retroactive effect.

(e) Any employee of the department of revenue collecting voluntary contributions for organ and tissue donations under the provisions of sections 42-2-107 (4) (b) (V) and 42-2-118 (1) (a) (II), C.R.S.; or

Editor's note: This version of paragraph (e) is effective until January 1, 2013.

(e) Any employee of the department of revenue collecting voluntary contributions for organ and tissue donations under sections 42-2-107 (4) (b) (V) and 42-2-118 (1) (a) (II), C.R.S.;

Editor's note: This version of paragraph (e) is effective January 1, 2013.

(f) A person whose only responsibility in connection with a charitable contribution is to provide a merchant account to process credit card payments using the internet.

Editor's note: This version of paragraph (f) is effective until January 1, 2013.

(f) A person whose only responsibility in connection with a charitable contribution is to provide a merchant account to process credit card payments using the internet; or

Editor's note: This version of paragraph (f) is effective January 1, 2013.

(g) A person who prepares a grant application for a charitable organization or purpose, unless the person's compensation is computed on the basis of funds to be raised or actually raised as a result of the grant application.

Editor's note: Paragraph (g) is effective January 1, 2013.

(8) "Person" means an individual, a corporation, an association, a partnership, a trust, a foundation, or any other entity however organized or any group of individuals associated in fact but not a legal entity.

(9) Repealed.

(9.3) "Professional fundraising consultant" means any person, other than a bona fide officer or regular employee of a charitable organization, who is retained by a charitable organization for a fixed fee or rate under a written agreement to plan, manage, advise, consult, or prepare material for or with respect to the solicitation in this state of contributions for a charitable organization but who does not solicit contributions or employ, procure, or engage any compensated person to solicit contributions. No lawyer, investment counselor, or banker who renders professional services to a charitable organization or advises a person to make a charitable contribution during the course of rendering professional services to the person shall be deemed, as a result of such professional services or advice, to be a "professional fundraising consultant".

(9.5) "Records" means books, financial statements, papers, correspondence, memoranda, agreements, or other documents or records that the secretary of state deems relevant or material to an inquiry.

(10) "Solicit" or "solicitation" means to request, or the request for, directly or indirectly, money, credit, property, financial assistance, or any other thing of value on the plea or representation that such money, credit, property, financial assistance, or other thing of value, or any portion thereof, will be used for a charitable purpose or will benefit a charitable organization. The term "solicit" or "solicitation" shall include, but need not be limited to, the following methods of requesting or securing such money, credit, property, financial assistance, or other thing of value:

(a) Any oral or written request; or

(b) Any sale or attempted sale of or any offer to sell any advertisement, advertising space, book, card, tag, coupon, device, magazine, membership, merchandise, subscription, flower, ticket, candy, cookies, or other tangible item in which any appeal is made for any charitable organization or purpose, or for which the name of any charitable organization is used or referred to in any such appeal as an inducement or reason for making any such sale, or for which any statement is made that the proceeds or any portion thereof from such sale will be used for any charitable purpose or will benefit any charitable organization. A "solicitation" shall be deemed to have taken place whether or not the person making the "solicitation" receives any contribution.

(11) "Solicitation campaign" means a series of solicitations which are made by the same person and which are similar in content or are based on a similar pitch or sales approach, which series leads up to or is represented to lead up to an event or lasts or is intended to last for a definite period of time. If the series of solicitations lasts or is intended to last for an indefinite period of time or for more than one year, a "solicitation campaign" means all similar solicitations made by the same person occurring within a particular calendar year.

(11.5) "Suspend" means that a charitable organization, professional fund-raising consultant, or paid solicitor is prohibited from soliciting contributions, providing consulting services in connection with a solicitation campaign, or conducting a solicitation campaign in Colorado.

(12) "Volunteer" means a person who renders services to a charitable organization or for a charitable purpose and who neither receives nor is expressly or impliedly promised financial remuneration for said services.

Source: L. 88: Entire article added, p. 350, § 1, effective July 1. **L. 89:** (6) and (9) repealed and IP(7) amended, pp. 367, 364, §§ 8, 1, effective July 1. **L. 96:** (1) and (5) amended and (7)(e) added, p. 1135, §§ 3, 4, effective July 1. **L. 2001:** IP(7) amended and

(9.3) added, p. 1236, § 1, effective May 9, 2002. **L. 2003:** (7)(f) added, p. 2496, § 1, effective June 5. **L. 2005:** (7)(b) and (9.3) amended, p. 1286, § 1, effective June 3. **L. 2008:** (9.5) and (11.5) added, p. 806, § 2, effective September 1. **L. 2012:** (7)(e) and (7)(f) amended and (7)(g) added, (HB 12-1236), ch. 133, p. 456, § 1, effective January 1, 2013.

Editor's note: Section 6 of chapter 133, Session Laws of Colorado 2012, provides that the act amending subsections (7)(e) and (7)(f) and adding subsection (7)(g) applies to actions occurring on or after January 1, 2013.

6-16-104. Charitable organizations - initial registration - annual filing - fees. (1) Every charitable organization, except those exempted under subsection (6) of this section, that intends to solicit contributions in this state by any means or to have contributions solicited in this state on its behalf by any other person or entity or that participates in a charitable sales promotion shall, prior to engaging in any of these activities, file a registration statement with the secretary of state upon a form prescribed by the secretary of state. Each chapter, branch, or affiliate of a charitable organization that is required to file a registration statement under this section either shall file a separate registration statement or shall report the necessary information to its parent charitable organization, which then shall file a consolidated registration statement.

(2) The registration statement shall be signed and sworn to under oath by an officer of the charitable organization, which may include its chief fiscal officer, and shall contain the following information:

Editor's note: This version of the introductory portion to subsection (2) is effective until January 1, 2013.

(2) The registration statement must be signed and sworn to under oath by an officer of the charitable organization, which may include its chief fiscal officer, and must contain the following information:

Editor's note: This version of the introductory portion to subsection (2) is effective January 1, 2013.

(a) The name of the charitable organization, the purpose for which it is organized, and the name or names under which it intends to solicit contributions;

(b) The address and telephone number of the principal place of business of the charitable organization and the address and telephone number of any offices in this state, or, if the charitable organization does not maintain an office in this state, the name, address, and telephone number of the person that has custody of its financial records;

(c) The names and addresses of the officers, directors, trustees, and executive personnel of the charitable organization;

(d) The last day of the fiscal year of the charitable organization;

(e) The place and date when the charitable organization was legally established, the form of its organization, and its tax-exempt status;

(f) A financial report for the most recent fiscal year, upon a form prescribed by the secretary of state, or, in the discretion of the secretary of state, a copy of the charitable organization's federal form 990, with all schedules except schedules of donors, for the most recent fiscal year. If, at the time of the initial registration, the charitable organization does not have the required financial report or form 990 for the most recent fiscal year, the charitable organization shall submit a financial report or form 990 for the most recent fiscal year in which such information is available. An organization that was first legally established within the past year and thus does not have financial information or a form 990 for its most recent fiscal year shall provide to the secretary of state a financial report based on good faith estimates for its current fiscal year on a form prescribed by the secretary of state. Any organization that files a good faith estimate for its first fiscal year shall amend its initial registration statement to report actual financial information no later than the fifteenth day of the fifth month after the close of the organization's first fiscal year.

Editor's note: This version of paragraph (f) is effective until January 1, 2013.

(f) A financial report for the most recent fiscal year, upon a form prescribed by the secretary of state, or, in the discretion of the secretary of state, a copy of the charitable organization's federal form 990, with all schedules except schedules of donors, for the most recent fiscal year. If, at the time of the initial registration, the charitable organization does not have the required financial report or form 990 for the most recent fiscal year, the charitable organization shall submit a financial report or form 990 for the most recent fiscal year in which such information is available. An organization that was first legally established within the past year and thus does not have financial information or a form 990 for its most recent fiscal year shall provide to the secretary of state a financial report based on good faith estimates for its current fiscal year on a form prescribed by the secretary of state. Any organization that files a good faith estimate for its first fiscal year shall amend its initial registration statement to report actual financial information on or before the earlier of the fifteenth day of the eighth month after the close of the organization's first fiscal year or the date authorized for filing a form 990 with the internal revenue service.

Editor's note: This version of paragraph (f) is effective January 1, 2013.

(g) The names and addresses of any paid solicitors, professional fundraising consultants, and commercial coventurers who are acting or have agreed to act on behalf of the charitable organization. If the paid solicitor, professional fundraising consultant, or commercial coventurer is a partnership, corporation, limited liability company, or other legal entity, the charitable organization shall list only the name and address of the legal entity.

(3) The secretary of state may promulgate rules concerning the acceptance of a uniform multistate registration statement, such as a unified registration statement, in lieu of the registration statement described in subsection (2) of this section. As soon as practicable, the secretary of state shall take steps to cooperate in a joint state and federal electronic filing project involving state charity offices and the internal revenue service to enable and promote electronic filing of uniform multistate registration statements and federal annual information returns.

(4) The registration of a charitable organization shall be amended annually, on forms prescribed by the secretary of state, to reflect any changes of name, address, principals, corporate forms, tax status, and any other changes that materially affect the identity or business of the charitable organization. Annual amendments shall be filed at the same time as and together with any financial report required in subsection (5) of this section regardless of when the charitable organization filed its initial registration pursuant to subsection (1) of this section.

(5) Every charitable organization required to register under this section shall annually file with the secretary of state a financial report for the most recent fiscal year on a form prescribed by the secretary of state, or, in the discretion of the secretary of state, a copy of the charitable organization's federal form 990, with all schedules except schedules of donors, for the most recent fiscal year. Such financial report shall be filed on or before the fifteenth day of the fifth calendar month after the close of each fiscal year in which the charitable organization solicited in this state. A charitable organization that is unable to file a copy of its form 990 return or the secretary of state's financial form by the prescribed deadline may request an extension of the filing deadline from the secretary of state. All such requests shall be made and granted under terms, conditions, and procedures that are substantially similar to the terms, conditions, and procedures applicable to obtaining an extension of time to file a form 990 return from the internal revenue service. A charitable organization shall provide the secretary of state with its most recently completed form 990 return, or such financial information as the secretary of state may require, in a form prescribed by the secretary of state, during the extension period. An organization that was first legally established within the past year and thus does not have financial information or a form 990 for its most recent fiscal year shall provide to the secretary of state a financial report based on good faith estimates for its current fiscal year on a form prescribed by the secretary of state.

Editor's note: This version of subsection (5) is effective until January 1, 2013.

(5) Every charitable organization required to register under this section shall annually file with the secretary of state a financial report for the most recent fiscal year on a form prescribed by the secretary of state, or, in the discretion of the secretary of state, a copy of the charitable organization's federal form 990, with all schedules except schedules of donors, for the most recent fiscal year. The financial report must be filed on or before the earlier of the fifteenth day of the eighth calendar month after the close of each fiscal year in which the charitable organization solicited in this state or the date authorized for filing a form 990 with the internal revenue service. A charitable organization that is unable to file a copy of its form 990 return or the secretary of state's financial form by the prescribed deadline may request an extension of the filing deadline from the secretary of state. The secretary of state, upon receipt of an application to extend the filing deadline, may grant a three-month extension of time to file the financial report. All such requests must be in a form prescribed by the secretary of state and must include a statement describing in detail the reasons causing the delay in filing the financial report and an affirmation that the charitable organization has filed with the internal revenue service an application for a corresponding extension of time to file the organization's form 990. Upon request, the charitable organization shall provide the secretary of state with a copy of its application for extension of time to file with the internal revenue service in order to verify the date authorized for filing its form 990 with the internal revenue service.

Editor's note: This version of subsection (5) is effective January 1, 2013.

(6) The following shall not be required to file a registration statement:

Editor's note: This version of the introductory portion to subsection (6) is effective until January 1, 2013.

(6) The following are not required to file a registration statement:

Editor's note: This version of the introductory portion to subsection (6) is effective January 1, 2013.

(a) Persons that are exempt from filing a federal annual information return pursuant to 26 U.S.C. sec. 6033 (a) (2), (3) (A) (I), (3) (A) (III), or (3) (C) (i) or pursuant to 26 CFR 1.6033-2 (g) (1) (i) to (g) (1) (iv) or (g) (1) (vii);

(b) Political parties, candidates for federal or state office, and political action committees required to file financial information with federal or state elections commissions; and

Editor's note: This version of paragraph (b) is effective until January 1, 2013.

(b) Political parties, candidates for federal or state office, and political action committees required to file financial information with federal or state elections commissions;

Editor's note: This version of paragraph (b) is effective January 1, 2013.

(c) Charitable organizations that do not intend to and do not actually raise or receive gross revenue, excluding grants from governmental entities or from organizations exempt from federal taxation under section 501(c) (3) of the federal "Internal Revenue Code of 1986", as amended, in excess of twenty-five thousand dollars during a fiscal year or do not receive contributions from more than ten persons during a fiscal year. The exemption authorized in this paragraph (c) shall not apply to a charitable organization that has contracted with a paid solicitor to solicit contributions in this state for the organization.

(d) Persons exclusively making appeals for funds on behalf of a specific individual named in the solicitation, but only if all of the proceeds of the solicitation are given to or expended for the direct benefit of the specified individual.

Editor's note: Paragraph (d) is effective January 1, 2013.

(7) Filing fees for the annual registration of a charitable organization and for amendments thereto shall be established by the secretary of state in an amount that reflects the costs of the secretary of state in administering the provisions of this article. All such fees collected shall be deposited in the department of state cash fund created in section 24-21-104 (3) (b), C.R.S.

(8) The secretary of state shall examine each registration to determine whether the applicable requirements of this section are satisfied. The secretary of state shall notify the charitable organization within ten days after receipt of its application of any deficiencies therein, otherwise the registration shall be deemed approved as filed. The secretary of state shall issue each approved applicant a registration number.

(9) No charitable organization that is required to register under this chapter shall, prior to registration, solicit contributions in this state by any means, have contributions solicited in this state on its behalf by any other person or entity, or participate in a charitable sales promotion.

(10) All information filed pursuant to this section, except for residential addresses and telephone numbers of individuals and schedules of contributors listed on the federal form 990 or its equivalent, shall be considered public records for purposes of the public records law, part 2 of article 72 of title 24, C.R.S.

Source: L. 88: Entire article added, p. 352, § 1, effective July 1. **L. 89:** (1)(d), (1)(e), and (2) amended and (5) and (6) repealed, pp. 364, 367, §§ 2, 8, effective July 1. **L. 2001:** Entire section R&RE, p. 1237, § 2, effective May 9, 2002. **L. 2002:** (2)(f), (4), and (5) amended, p. 948, § 1, effective June 1. **L. 2003:** IP(2) and (6)(a) amended, p. 2496, § 2, effective June 5. **L. 2005:** (2)(f), (3), and (6)(c) amended and (2)(g) added, p. 1287, § 2, effective June 3. **L. 2009:** (6)(a) amended, (SB 09-292), ch. 369, p. 1986, § 133, effective August 5. **L. 2012:** IP(2), (2)(f), (5), IP(6), and (6)(b) amended and (6)(d) added, (HB 12-1236), ch. 133, p. 457, § 2, effective January 1, 2013.

Editor's note: Section 6 of chapter 133, Session Laws of Colorado 2012, provides that the act amending the introductory portion to subsection (2), subsections (2)(f) and (5), the introductory portion to subsection (6), and subsection (6)(b) and adding subsection (6)(d) applies to actions occurring on or after January 1, 2013.

6-16-104.3. Professional fundraising consultants - annual registration - fees. (1) No person shall act as a professional fundraising consultant without first complying with the requirements of this section.

(2) Every contract between a professional fundraising consultant and a charitable organization or sponsor shall be in writing and signed by an authorized official of the charitable organization. The professional fundraising consultant shall provide a copy of the contract to the charitable organization prior to the performance of any material services under the contract and shall make a copy of the contract available to the secretary of state upon request. The contract shall contain all of the following provisions:

(a) A statement of the charitable purpose for which the solicitation campaign is being conducted;

(b) A statement of the respective obligations of the professional fundraising consultant and the charitable organization;

(c) Whether the professional fundraising consultant will at any time have custody or control of contributions;

(d) A clear statement of the fees that will be paid to the professional fundraising consultant or, if the fees are to be calculated based on a percentage of contributions or other formula, a clear statement of the percentage or other formula; and

(e) The effective and termination dates of the contract.

(3) A professional fundraising consultant who at any time has or will have custody or control of contributions from a solicitation conducted on behalf of a charitable organization in this state shall also comply with the registration requirements of this section before performing any material services with respect to such solicitation.

(4) Applications for registration or renewal of registration shall be submitted on a form prescribed by the secretary of state, shall be signed under oath, and shall include the following information:

(a) The address and telephone number of the principal place of business of the applicant and the address and telephone number of any office located in this state if the principal place of business is located outside the state;

(a.5) The form of the applicant's business and, if the applicant is not an individual, the place and date when the applicant was incorporated or otherwise legally established;

(b) The name, address, and telephone number of the person that has custody of the applicant's financial records;

(c) If the applicant is not an individual, the names and addresses of the owners, officers, and executive personnel of the applicant;

(d) Whether the applicant or any of its owners, officers, directors, trustees, or employees have, within the immediately preceding five years, been convicted of, found guilty of, pled guilty or nolo contendere to, been adjudicated a juvenile violator of, or been incarcerated for any felony involving fraud, theft, larceny, embezzlement, fraudulent conversion, or misappropriation of property or any crime arising from the conduct of a solicitation for a charitable organization or sponsor, under the laws of this or any other state or of the United States, and if so, the name of such person, the nature of the offense, the date of the offense, the court having jurisdiction in the case, the date of conviction or other disposition, and the disposition of the offense;

(e) Whether the applicant or any of its owners, officers, directors, trustees, or employees have been enjoined from violating any law relating to a charitable solicitation or from engaging in charitable solicitation and, if so, the name of such person, the date of the injunction, and the court issuing the injunction;

(f) Whether the applicant is registered with or otherwise authorized by any other state to act as a professional fundraising consultant; and

(g) Whether the applicant has had such registration or authority denied, suspended, revoked, or enjoined by any court or other governmental authority in this state or another state.

(5) The application for registration or for renewal shall be accompanied by the fee established pursuant to subsection (12) of this section. A professional fundraising consultant that is a partnership, corporation, or limited liability company may register for and pay a single fee on behalf of all its partners, members, officers, directors, agents, and employees. In such case, the names and street addresses of all the partners, members, officers, directors, employees, and agents of the fundraising consultant and all other persons with whom the fundraising consultant has contracted to work under its direction shall be listed in the application or furnished to the secretary of state within five days after the date of employment or contractual arrangement.

(6) Each registration is valid for a period of one year and may be renewed, on or before the anniversary date, for an additional one-year period upon application to the secretary of state and payment of the registration fee. Any material changes to the information contained in the application for registration shall be reported in writing to the secretary of state within thirty days.

(7) The secretary of state shall examine each registration to determine whether the applicable requirements of this section are satisfied. The secretary of state shall notify the applicant within ten days after receipt of its application of any deficiencies therein, otherwise the application shall be deemed approved as filed. The secretary of state shall issue each approved applicant a registration number.

(8) If a professional fundraising consultant will have custody of any contribution received during a solicitation campaign, each such contribution shall be deposited within two business days after its receipt in an account at a bank or other federally insured financial institution. The account shall be in the name of the charitable organization with whom the professional fundraising consultant has contracted, and the charitable organization shall have sole control over all withdrawals from the account.

(9) Within ninety days after a solicitation campaign has been concluded, and on the anniversary of the commencement of a solicitation campaign lasting more than one year, the professional fundraising consultant shall provide to the charitable organization a financial report of the campaign, including gross proceeds and an itemization of all expenses or disbursements for any purpose. The report shall be signed by the professional fundraising consultant or, if the professional fundraising consultant is not an individual, by an authorized officer or agent of the professional fundraising consultant, who shall certify that the financial report is true and complete to the best of the person's knowledge. The

professional fundraising consultant shall provide a copy of the report to the secretary of state upon request.

(10) No person may act as a professional fundraising consultant and no professional fundraising consultant required to be registered under this section shall knowingly employ any person as an officer, trustee, director, or employee if such person, within the immediately preceding five years, has been convicted of, found guilty of, pled guilty or nolo contendere to, been adjudicated a juvenile violator of, or been incarcerated for any felony involving fraud, theft, larceny, embezzlement, fraudulent conversion, or misappropriation of property or any crime arising from the conduct of a solicitation for a charitable organization or sponsor, under the laws of this or any other state or of the United States, or has been enjoined within the immediately preceding five years under the laws of this or any other state or of the United States from engaging in deceptive conduct relating to charitable solicitations.

(11) All information filed pursuant to this section, except for residential addresses and telephone numbers of individuals, shall be considered public records for purposes of the public records law, part 2 of article 72 of title 24, C.R.S.

(12) Filing fees for the annual registration of a professional fundraising consultant and for amendments thereto shall be established by the secretary of state in an amount that reflects the costs of the secretary of state in administering the provisions of this article. All such fees collected shall be deposited in the department of state cash fund created in section 24-21-104 (3) (b), C.R.S.

Source: L. 2001: Entire section added, p. 1239, § 3, effective May 9, 2002. **L. 2003:** IP(2) amended, p. 2497, § 3, effective June 5. **L. 2005:** (4)(a.5) added and (4)(c) amended, p. 1288, § 3, effective June 3.

6-16-104.5. Additional reporting requirements. (Repealed)

Source: L. 92: Entire section added, p. 235, § 1, effective June 1.

Editor's note: Subsection (2) provided for the repeal of this section, effective December 31, 1994. (See L. 92, p. 235.)

6-16-104.6. Paid solicitors - annual registration - filing of contracts - fees. (1) (a) No person shall act as a paid solicitor without first complying with the requirements of this section.

(b) Every paid solicitor shall register in accordance with subsection (3) of this section before soliciting contributions in this state.

(2) Every contract between a paid solicitor and a charitable organization or sponsor for each solicitation campaign shall be in writing and shall be signed by an authorized official of the charitable organization or sponsor, who shall be a member of the organization's governing body, and by the paid solicitor if the paid solicitor is an individual or by the authorized contracting officer for the paid solicitor if the paid solicitor is not an individual. The paid solicitor shall provide a copy of the contract to the charitable organization prior to the performance of any material services under the contract and shall make a copy of the contract available to the secretary of state upon request. The contract shall contain all of the following provisions:

(a) A statement of the charitable purpose for which the solicitation campaign is being conducted;

(b) A statement of the respective obligations of the paid solicitor and the charitable organization;

(c) A statement of the specified minimum percentage, if any, of the gross receipts from contributions that will be remitted to the charitable organization, or, if the solicitation involves the sale of goods, services, or tickets to a fundraising event, the specified minimum percentage, if any, of the purchase price that will be remitted to the charitable organization.

Any stated percentage shall exclude any amount payable by the charitable organization as fundraising costs.

(d) A statement of the specified percentage, if any, of gross revenue that constitutes the paid solicitor's compensation. If the paid solicitor's compensation is not contingent upon the number of contributions or the amount received, the paid solicitor's compensation shall be expressed as a reasonable estimate of the percentage of gross revenue, and the contract shall clearly disclose the assumptions upon which such estimate is based. The stated assumptions shall be based upon all the relevant facts known to the paid solicitor regarding the solicitation to be conducted.

(e) The effective and termination dates of the contract.

(3) Applications for registration or renewal of registration shall be submitted on a form prescribed by the secretary of state, shall be signed under oath, and shall include the following information:

(a) The address and telephone number of the principal place of business of the applicant and the address and telephone number of any office located in this state if the principal place of business is located outside the state;

(b) The form of the applicant's business and, if the applicant is not an individual, the place and date when the applicant was incorporated or otherwise legally established;

(c) The name, address, and telephone number of the person that has custody of the applicant's financial records;

(d) If the applicant is not an individual, the names and addresses of the owners, officers, and executive personnel of the applicant;

(e) The names of all persons in charge of any solicitation activity conducted in this state by the applicant or on the applicant's behalf;

(f) Whether the applicant, any person with a controlling interest in the applicant, or any of the applicant's owners, officers, directors, trustees, employees, or agents has, within the immediately preceding five years, been convicted of, found guilty of, pled guilty or nolo contendere to, been adjudicated a juvenile violator of, or been incarcerated for any felony involving fraud, theft, larceny, embezzlement, fraudulent conversion, or misappropriation of property or any crime arising from the conduct of a solicitation for a charitable organization or sponsor, under the laws of this or any other state or of the United States, and if so, the name of such person, the nature of the offense, the date of the offense, the court having jurisdiction in the case, the date of conviction or other disposition, and the disposition of the offense;

(g) Whether the applicant or any of its owners, officers, directors, trustees, or employees have been enjoined from violating any law relating to a charitable solicitation and, if so, the name of such person, the date of the injunction, and the court issuing the injunction;

(h) Whether the applicant is registered with or otherwise authorized by any other state to act as a paid solicitor; and

(i) Whether the applicant has had such registration or authority denied, suspended, revoked, or enjoined by any court or other governmental authority in this state or another state.

(4) The application for registration or for renewal shall be accompanied by the fee established pursuant to subsection (12) of this section. A paid solicitor that is a partnership, corporation, or limited liability company may register for and pay a single fee on behalf of all its partners, members, officers, directors, agents, and employees. In such case, the names and street addresses of all the partners, members, officers, directors, employees, and agents of the paid solicitor and all other persons with whom the paid solicitor has contracted to work under its direction shall be listed in the application or furnished to the secretary of state within five days after the date of employment or contractual arrangement.

(5) Each registration is valid for a period of one year and may be renewed, on or before the anniversary date, for an additional one-year period upon application to the secretary of state and payment of the registration fee. Any material changes to the information contained in the application for registration shall be reported in writing to the secretary of state within thirty days.

(6) The secretary of state shall examine each registration to determine whether the applicable requirements of this section are satisfied. The secretary of state shall notify the

applicant within ten days after receipt of its application of any deficiencies therein, otherwise the application shall be deemed approved as filed. The secretary of state shall issue each approved applicant a registration number.

(7) No later than fifteen days before the commencement of a solicitation campaign, the paid solicitor shall file with the secretary of state a completed solicitation notice, on forms prescribed by the secretary of state, containing the following information:

(a) A summary of the governing contract, as specified in subsection (2) of this section;

(b) The full legal name and address of the paid solicitor who will be conducting the solicitation campaign and the full legal name and address of each person responsible for directing and supervising the conduct of the campaign;

(c) A statement, in accordance with section 6-16-111 (1) (f) and (1) (g), of the nature of the intended solicitation campaign, including the means of communication to be used in the campaign, the projected commencement and conclusion dates of the campaign, and a description of any event the campaign will lead up to;

(d) A full and fair statement, in accordance with section 6-16-111 (1) (f) and (1) (g), of the charitable purpose for which the solicitation campaign is being carried out;

(e) Each location and telephone number, if applicable, from which the solicitation is to be conducted;

(f) A statement as to whether the paid solicitor will at any time have custody of contributions;

(g) The account number and location of each bank account where receipts from the campaign are to be deposited;

(h) The address where records and accounting concerning the solicitation campaign are being kept; and

(i) A certification statement, signed by an officer of the charitable organization on the behalf of whom the solicitation campaign is to occur, stating that the solicitation notice and accompanying material are true and complete to the best of his or her knowledge.

(8) If a paid solicitor will have custody of any contribution received during a solicitation campaign, each such contribution shall be deposited within two business days after its receipt in an account at a bank or other federally insured financial institution. The account shall be in the name of the charitable organization with whom the paid solicitor has contracted, and the charitable organization shall have sole control over all withdrawals from the account.

Editor's note: This version of subsection (8) is effective until January 1, 2013.

(8) If a paid solicitor will have custody of any monetary contribution received during a solicitation campaign, each such contribution must be deposited within two business days after its receipt in an account at a bank or other federally insured financial institution. The account must be in the name of the charitable organization with whom the paid solicitor has contracted, and the charitable organization must have sole control over all withdrawals from the account.

Editor's note: This version of subsection (8) is effective January 1, 2013.

(9) Within ninety days after a solicitation campaign has been concluded, and on the anniversary of the commencement of a solicitation campaign lasting more than one year, the paid solicitor shall provide to the charitable organization and file with the secretary of state a financial report of the campaign, including gross proceeds and an itemization of all expenses or disbursements for any purpose. The report shall be on a form prescribed by the secretary of state and shall be signed by the paid solicitor, or, if the paid solicitor is not an individual, by an authorized official of the paid solicitor, and by an authorized official of the charitable organization. The persons signing the report shall certify that the financial report is true and complete to the best of their knowledge.

(10) No person may act as a paid solicitor and no paid solicitor required to be registered under this section shall knowingly employ any person as an officer, trustee, director, or employee if such person, within the immediately preceding five years, has been convicted of, found guilty of, pled guilty or nolo contendere to, been adjudicated a juvenile violator of, or been incarcerated for any felony involving fraud, theft, larceny, embezzlement,

fraudulent conversion, or misappropriation of property or any crime arising from the conduct of a solicitation for a charitable organization or sponsor, under the laws of this or any other state or of the United States, or has been enjoined within the immediately preceding five years under the laws of this or any other state or of the United States from engaging in deceptive conduct relating to charitable solicitations.

(11) All information filed pursuant to this section, except for residential addresses and telephone numbers of individuals, shall be considered public records for purposes of the public records law, part 2 of article 72 of title 24, C.R.S.

(12) Filing fees for the annual registration of a paid solicitor, amendments thereto, solicitation notices, and financial reports shall be established by the secretary of state in amounts that reflects the costs of the secretary of state in administering the provisions of this article. All such fees collected shall be deposited in the department of state cash fund created in section 24-21-104 (3) (b), C.R.S.

Source: L. 2001: Entire section added, p. 1239, § 3, effective May 9, 2002. **L. 2003:** IP(2) amended, p. 2497, § 4, effective June 5. **L. 2005:** IP(2) amended, p. 1288, § 4, effective June 3. **L. 2012:** (8) amended, (HB 12-1236), ch. 133, p. 458, § 3, effective January 1, 2013.

Editor's note: Section 6 of chapter 133, Session Laws of Colorado 2012, provides that the act amending subsection (8) applies to actions occurring on or after January 1, 2013.

6-16-105. Written confirmation of contribution - disclosures. (1) A paid solicitor who makes an oral solicitation by telephone, door-to-door, or otherwise shall furnish to each contributor, prior to collecting or attempting to collect any contribution, a written confirmation of the expected contribution, which confirmation shall contain the following information clearly and conspicuously:

(a) The full legal name, address, telephone number, and registration number of the employer of the individual paid solicitor who directly communicated with the contributor;

(b) A disclosure that the contribution is not tax-deductible, if such disclosure is applicable, or, if the solicitor maintains that the contribution is tax-deductible in whole or in part, the portion of the contribution that the solicitor maintains is tax-deductible;

(c) A disclosure in capital letters of no less than ten-point, bold-faced type identifying the paid solicitor as a paid solicitor and containing the statement: "Registration by the secretary of state is not an endorsement of either the paid solicitor or the organization or cause the solicitor represents.";

(d) The address and telephone number of the telephone room or other location from which the solicitation has been or is being conducted if such information is different than that which is provided pursuant to paragraph (a) of this subsection (1); except that this information is not required to be provided if telephone solicitations are being conducted from more than one location and from the residences of the individual paid solicitor;

(e) The name, address, telephone number, and registration number of any charitable organization connected with the solicitation or any organization the name or symbol of which has been used in aid of or in the course of such solicitation;

(f) The amount of any expected monetary contribution;

(g) The name and address of the contributor, as well as the date of the individual solicitation, or spaces where this information may be filled in by the contributor;

(h) A statement that Colorado residents may obtain copies of registration and financial documents from the office of the secretary of state, with a current telephone number and web site address for obtaining such documents from the secretary of state.

(2) If the contributor is absent when the contribution is to be collected, the paid solicitor may comply with subsection (1) of this section by furnishing the written confirmation in a manner previously agreed upon between said solicitor and the contributor.

(3) Except for the amount of the expected contribution, a written solicitation shall contain the same information as is required in subsection (1) of this section.

Source: L. 88: Entire article added, p. 353, § 1, effective July 1. **L. 89:** Entire section R&RE, p. 365, § 3, effective July 1. **L. 2001:** IP(1), (1)(a), (1)(b), (1)(c), (1)(d), and (1)(e) amended and (1)(h) added, p. 1246, § 4, effective May 9, 2002.

Editor's note: For discussion of language in the North Carolina Charitable Solicitations Act relating to the disclosure of information concerning the amount of gross receipts turned over to charities, a requirement of this section prior to the 1989 amendment, see Riley v. National Federation of the Blind of North Carolina, 487 U.S. 781, 108 S. Ct. 2667, 101 L. Ed.2d 669 (1988).

6-16-105.3. Solicitations by telephone. (1) In addition to any other disclosure required for solicitations by telephone under section 6-16-105, a paid solicitor as defined in section 6-16-103 (7) who makes an oral solicitation to any person by a telephone call received in Colorado regarding a charitable contribution shall make the following oral disclosures as part of the telephone solicitation:

Editor's note: This version of the introductory portion to subsection (1) is effective until January 1, 2013.

(1) In addition to any other disclosure required for solicitations by telephone under section 6-16-105, a paid solicitor who makes an oral solicitation to any person by a telephone call received in Colorado regarding a charitable contribution shall make the following oral disclosures as part of the telephone solicitation:

Editor's note: This version of the introductory portion to subsection (1) is effective January 1, 2013.

(a) A statement that the person soliciting the charitable contribution by telephone is paid to make such solicitation;

(b) The name of the telemarketing company that employs the paid solicitor;

(c) The name and telephone number of the charitable organization on whose behalf the paid solicitor is making the solicitation;

(d) (Deleted by amendment, L. 2001, p. 1247, § 5, effective May 9, 2002.)

(d.5) The first name and surname of the paid solicitor, which must be given in the opening greeting;

Editor's note: Paragraph (d.5) is effective January 1, 2013.

(e) A statement that the charitable contribution is not tax deductible, if such is the case;

Editor's note: This version of paragraph (e) is effective until January 1, 2013.

(e) A statement, which must be made prior to the person's agreement to make a contribution, that the charitable contribution is not tax deductible, if such is the case;

Editor's note: This version of paragraph (e) is effective January 1, 2013.

(f) Upon request by a person from whom a charitable contribution is sought, the percentage of the contribution that will be paid to the charitable organization as a result of such person's contribution; and

(g) Upon request by a person from whom a charitable contribution is sought, the registration numbers of the charitable organization and the paid solicitor.

(2) A volunteer as defined in section 6-16-103 (12) who makes an oral solicitation to any person by a telephone call received in Colorado regarding a charitable contribution is subject to the disclosure required under paragraph (e) of subsection (1) of this section.

(3) Nothing in this section shall be construed as restricting, superseding, abrogating, or contravening any state or federal law or regulation regarding charitable solicitations.

Source: L. 97: Entire section added, p. 404, § 1, effective July 1. **L. 2001:** (1)(d) amended and (1)(g) added, p. 1247, § 5, effective May 9, 2002. **L. 2012:** IP(1) and (1)(e) amended and (1)(d.5) added, (HB 12-1236), ch. 133, p. 458, § 4, effective January 1, 2013.

Editor's note: Section 6 of chapter 133, Session Laws of Colorado 2012, provides that the act amending the introductory portion to subsection (1) and subsection (1)(e) and adding subsection (1)(d.5) applies to actions occurring on or after January 1, 2013.

ANNOTATION

The disclosure mandated by subsection (1)(d) is unconstitutional. Subsection (1)(d) violates the first and fourteenth amendments to the United States Constitution. Nat'l Fed'n of the Blind v. Norton, 981 F. Supp. 1371 (D. Colo. 1997).

Subsection (1)(d) is not narrowly tailored to the general assembly's stated purpose of fraud prevention. The state could publish or otherwise publicize the rights of donors to rescind telephone contributions, thereby educating the public without burdening the free speech rights of a specific category of charitable fundraisers, namely paid solicitors. Nat'l Fed'n of the Blind v. Norton, 981 F. Supp. 1371 (D. Colo. 1997).

By mandating that only paid fundraisers tell donors they have three days to rescind their pledge, subsection (1)(d) harms and discriminates against only those charities that rely on paid fundraisers. Nat'l Fed'n of the Blind v. Norton, 981 F. Supp. 1371 (D. Colo. 1997).

6-16-105.5. Solicitations by container - disclosures. (1) (a) No person or charitable organization, or agent of a person or charitable organization, whether paid or not paid, shall place any container offering a product for sale or distribution in a public place for solicitation purposes unless the container is affixed with a disclosure label conspicuously displaying the information set forth in subsection (2) of this section in a typed or printed clearly legible form.

(b) (I) A person other than an organization that has received a determination that it is exempt under section 501 (c) (3) of the federal "Internal Revenue Code of 1986", as amended, who places a container in a public place for solicitation purposes and who does not direct all of the items placed in the container to a charitable purpose or, if the items are sold, does not direct all proceeds of such sale to a charitable purpose, shall affix to the container a disclosure label that clearly and conspicuously displays the following legend:

DONATED ITEMS WILL BE SOLD FOR PROFIT

The value of items placed in this container is NOT tax-deductible.

(II) This paragraph (b) shall not apply to containers used exclusively for the collection of used paper, cardboard, motor oil, bottles, cans, or other containers or materials for recycling or waste diversion purposes.

(2) The disclosure label required pursuant to paragraph (a) of subsection (1) of this section shall state the following:

(a) The percentage of annual contributions that are paid to any person or organization to maintain, service, or collect the contributions deposited in all the containers used by the person or charitable organization;

(b) The percentage of annual contributions that are paid to the charitable organization specified on the container;

(c) Whether the person maintaining, servicing, or collecting the contributions deposited in the container is a volunteer or is paid for the services.

(3) For purposes of this section, "container" means a box, carton, package, receptacle, canister, jar, dispenser, or machine.

(4) Nothing in this section shall be construed as restricting, superseding, abrogating, or contravening any state or federal law or regulation regarding charitable solicitations.

Source: L. 96: Entire section added, p. 291, § 1, effective July 1. **L. 2009:** (1) and IP(2) amended, (HB 09-1052), ch. 50, p. 178, § 1, effective August 5.

6-16-106. Contributor's right to cancel. (1) In addition to any right otherwise provided by law with respect to the binding nature of an agreement or pledge to make a

charitable contribution, a contributor shall have the right to cancel his agreement or pledge to contribute as follows:

(a) With respect to a solicitation in which the paid solicitor knowingly fails to comply with this article, at any time; or

(b) Until 12 midnight of the third business day, or with respect to a nonmonetary contribution, until 12 midnight of the first business day after the day on which the contributor receives a written confirmation of contribution pursuant to section 6-16-105.

(2) Cancellation occurs when the contributor gives written or oral notice of the cancellation to the paid solicitor at the address or telephone number stated in the written confirmation of contribution.

(3) Notice of cancellation, if given by mail, is given at the time it is properly addressed and deposited in a mail box with proper postage.

(4) A particular form shall not be required for a notice of cancellation, and such notice shall be sufficient if it indicates the intention of the contributor to cancel his pledge to contribute.

(5) Within ten days after a notification of cancellation has been received by the paid solicitor, the paid solicitor shall tender to the contributor any contribution made and any note or other evidence of indebtedness.

(6) Allowing for ordinary wear and tear or consumption of the goods contemplated by the transaction, within a reasonable time after an agreement or pledge to contribute has been cancelled, the contributor upon demand must tender to the paid solicitor any goods or items delivered by the paid solicitor in connection with the contribution but shall not be under obligation to tender at any other place than where the goods or items were delivered. If the paid solicitor fails to demand possession of the goods or items within a reasonable time after cancellation, the goods or items become the property of the contributor without obligation to contribute. For purposes of this subsection (6), forty days is presumed to be a reasonable time.

Source: L. 88: Entire article added, p. 355, § 1, effective July 1. **L. 89:** Entire section R&RE, p. 365, § 4, effective July 1.

6-16-107. Donated tickets - sponsored attendance. No person, in the course of or in aid of a solicitation, shall represent that a contribution will purchase a ticket or tickets to be donated for use by another, sponsor the attendance of another at an event, or sponsor the receipt of a benefit by another while knowing that the donated tickets or sponsorships will not actually be used or received by the donees or beneficiaries in the quantity represented.

Source: L. 88: Entire article added, p. 355, § 1, effective July 1. **L. 89:** Entire section R&RE, p. 366, § 5, effective July 1.

6-16-108. Publications. (Repealed)

Source: L. 88: Entire article added, p. 356, § 1, effective July 1. **L. 89:** Entire section repealed, p. 367, § 8, effective July 1.

6-16-109. Records - accounts. (1) During each solicitation campaign, a paid solicitor shall create and maintain, for not less than two years after the completion of such campaign, the following records:

(a) Copies of all written confirmations or any standardized written confirmations provided pursuant to section 6-16-105;

(b) The name and residence address of each employee, agent, or other person involved in the solicitation as is on record at the time of such solicitation;

(c) The locations and account numbers of all bank or other financial institution accounts into which the paid solicitor has deposited receipts from the solicitation;

(d) Records indicating the quantity of donated tickets or sponsorships, as described in section 6-16-107, which were actually used or received by donees or beneficiaries;

(e) A complete record and accounting of the receipts and disbursements of funds derived from any solicitation campaign. Said record and accounting shall clearly identify any person or organization to whom or to which any part of such funds are transferred and shall describe with specificity the purpose for which any expenditure is made and the amount of each expenditure. Funds spent directly for any charitable purpose or transferred to any charitable organization as represented in the solicitations shall be clearly delineated as such.

(f) All written records relating to pitches, sales approaches, or disclosures used during any solicitation campaign and all instructions provided to paid solicitors concerning the content or solicitations;

(g) All contracts or agreements made with charitable organizations or other represented beneficiaries of solicitations; and

(h) For each contribution, records indicating the name and address of the contributor, the amount of the contribution if monetary, and the date of the contribution, together with the name of the individual paid solicitor who solicited the contribution.

(2) Any person involved in solicitations who claims an exemption from the definition of paid solicitor in section 6-16-103 (7) shall maintain records of ruling letters and other communications from the internal revenue service regarding tax-exempt status. Failure to produce such records on written demand of the district attorney pursuant to section 6-16-111 (1) (e) shall give rise to a rebuttable presumption that the person does not have a ruling letter granting tax-exempt status pursuant to 26 U.S.C. sec. 501 (c) (3).

(3) Repealed.

Source: L. 88: Entire article added, p. 356, § 1, effective July 1. **L. 89:** IP(1), (1)(a), (1)(d), (1)(f), (1)(g), (2), and (3) amended and (1)(h) added, p. 366, § 6, effective July 1. **L. 2001:** (3) repealed, p. 1247, § 6, effective May 9, 2002.

6-16-110. Charitable sales promotions. (1) The provisions of this article relating to commercial coventurers and charitable sales promotions shall apply only when a commercial coventurer reasonably expects that more than one-half of all proceeds of a solicitation campaign will be derived from transactions within the state of Colorado.

(2) A commercial coventurer shall disclose in each advertisement for a charitable sales promotion the dollar amount or percent per unit of goods or services purchased or used that will benefit the charitable organization or purpose. If the actual dollar amount or percentage cannot reasonably be determined prior to the final date of the charitable sales promotion, the commercial coventurer shall disclose an estimated dollar amount or percentage. Any such estimate shall be reasonable and shall be based upon all of the relevant facts known to the commercial coventurer regarding the charitable sales promotion.

(3) A commercial entity which purchases at wholesale a product which is created, manufactured, or produced by a charitable organization for resale to the general public as part of the commercial entity's general stock of merchandise shall be exempt from the provisions of this article relating to commercial coventurers and charitable sales promotions.

Source: L. 88: Entire article added, p. 357, § 1, effective July 1.

6-16-110.5. Secretary of state - dissemination of information - cooperation with other agencies - rules. (1) The secretary of state shall take steps to:

(a) Publicize the requirements of this article and otherwise assist charitable organizations, professional fundraising consultants, and paid solicitors in complying with this article;

(b) Compile and publish, on an annual basis, the information provided by charitable organizations, professional fundraising consultants, and paid solicitors under this article to assist the public in making informed decisions about charitable solicitation and to assist charitable organizations in making informed decisions about contracting with paid solicitors;

(c) Participate in a national online charity information system as soon as a system is established, if the secretary determines that participation will further advance the purposes of this subsection (1) and subsection (2) of this section.

(2) The secretary of state may exchange with appropriate authorities of this state, any other state, and the United States information with respect to charitable organizations, professional fundraising consultants, commercial coventurers, and paid solicitors.

(3) The secretary of state shall have the authority to promulgate rules as needed for the effective implementation of this section, including but not limited to:

(a) Providing for the extension of filing deadlines;

(b) Providing for the online availability of forms required to be filed pursuant to sections 6-16-104 to 6-16-104.6;

(c) Providing for the electronic filing of required forms, including the acceptance of electronic signatures;

(d) Mandating electronic filing and providing, in the secretary of state's discretion, for exceptions to mandatory electronic filing; and

(e) Setting fines for noncompliance with this article or rules promulgated pursuant to this article. The fine for soliciting while unregistered shall not exceed three hundred dollars per year for charities or one thousand dollars per year for paid solicitors.

Source: L. 2001: Entire section added, p. 1239, § 3, effective May 9, 2002. **L. 2002:** (3) amended, p. 949, § 2, effective June 1. **L. 2005:** (1)(c) added, p. 1288, § 5, effective June 3. **L. 2008:** (3) amended, p. 807, § 3, effective September 1.

6-16-111. Violations. (1) A person commits charitable fraud if he or she:

(a) Knowingly solicits any contribution and in the course of such solicitation knowingly performs any act or omission in violation of any of the provisions of sections 6-16-104 to 6-16-107 and 6-16-110;

(b) Knowingly solicits any contribution and, in aid of or in the course of such solicitation, utilizes the name or symbol of another person or organization without written authorization from such person or organization for such use;

(c) Solicits any contribution and, in aid of or in the course of such solicitation, utilizes a name, symbol, or statement which is closely related or similar to that used by another person or organization with the intent to mislead the person to whom the solicitation is made that said solicitation is on the behalf of or is affiliated with such other person or organization;

(d) With the intent to defraud, knowingly solicits contributions and, in aid of such solicitation, assumes, or allows to be assumed, a false or fictitious identity or capacity, except for a trade name or trademark registered in this state by that person or his employer;

(e) Knowingly fails to create and maintain all records required by section 6-16-109 to be created and maintained or knowingly fails to make available said records for examination and photocopying at the office of the district attorney or at his own office in this state with copying facilities furnished free of charge, within five days after a written demand for the production of said records by the district attorney, or within twenty days with respect to records kept out of state;

(f) Knowingly makes a misrepresentation of a material fact in any notice, report, or record required to be filed, maintained, or created by this article;

(g) With the intent to defraud, devises or executes a scheme or artifice to defraud by means of a solicitation or obtains money, property, or services by means of a false or fraudulent pretense, representation, or promise in the course of a solicitation. A representation may be any manifestation of any assertion by words or conduct, including, but not limited to, a failure to disclose a material fact.

(h) Represents or causes another to represent that contributions are tax-deductible unless they so qualify under the federal internal revenue code;

(i) Represents or causes another to represent that a contribution to a charitable organization will be used for a purpose other than the purpose for which the charitable organization actually intends to use such contribution;

(j) Represents or causes another to represent that a greater portion of the contribution will go to a charitable organization than the actual portion that will go to such organization;

(k) Represents or causes another to represent that the solicitor is located in a geographic area that is different from the geographic area in which the solicitor is actually located;

(l) Represents or causes another to represent that the solicitor has a sponsorship, approval, status, affiliation, or connection with an organization or purpose that the solicitor does not actually have;

(m) Represents or causes another to represent that the person to whom a solicitation is made is under an obligation to make a contribution;

(n) Represents or causes another to represent that failure to make a contribution will adversely affect the person's credit rating;

(o) Represents or causes another to represent that the person has previously approved or agreed to make a contribution when in fact the person has not given such approval or agreement; or

(p) Represents or causes another to represent that the person has previously contributed to the same organization or for the same purpose when in fact the person has not so contributed.

(1.5) A person commits charitable fraud if he or she, in the course of or in furtherance of a solicitation, misrepresents to, misleads, makes false statements to, or uses a name other than the solicitor's legal name in communicating with a person being solicited in any manner that would lead a reasonable person to believe that:

(a) If the person being solicited makes a contribution, he or she will receive special benefits or favorable treatment from a police, sheriff, patrol, firefighting, or other law enforcement agency or department of government; or

(b) If the person being solicited fails to make a contribution, he or she will receive unfavorable treatment from a police, sheriff, patrol, firefighting, or other law enforcement agency or department of government.

(2) Any person who commits charitable fraud in violation of paragraph (b), (c), (d), (f), or (g) of subsection (1) of this section is guilty of a class 5 felony, and upon conviction thereof, shall be punished in accordance with section 18-1.3-401, C.R.S.

(3) Any person who commits charitable fraud in violation of paragraph (a), (e), or (h) to (p) of subsection (1) of this section, or of subsection (1.5) of this section, is guilty of a class 2 misdemeanor and, upon conviction thereof, shall be punished in accordance with section 18-1.3-501, C.R.S.; except that a person who commits a violation of any one or more of said paragraphs with respect to solicitations involving three separate contributors in any one solicitation campaign is guilty of a class 5 felony, and upon conviction thereof, shall be punished in accordance with section 18-1.3-401, C.R.S.

(4) Charitable fraud which is a felony shall be deemed a class 1 public nuisance and subject to the provisions of part 3 of article 13 of title 16, C.R.S.

(5) Violation of any provision of this article also shall constitute a deceptive trade practice in violation of the "Colorado Consumer Protection Act", article 1 of this title, and shall be subject to remedies or penalties, or both, pursuant thereto.

(6) (a) In addition to any other applicable penalty, the secretary of state may deny, suspend, or revoke the registration of any charitable organization, professional fund-raising consultant, or paid solicitor that makes a false statement or omits material information in any registration statement, annual report, or other information required to be filed by this article or that acts or fails to act in such a manner as otherwise to violate any provision of this article. The secretary of state may also deny, suspend, or revoke the registration of any person who does not meet the requirements for registration set forth in this article.

(b) Upon notice from the secretary of state that a registration has been denied or is subject to suspension or revocation, the aggrieved party may request a hearing. The request for hearing must be made within five calendar days after receipt of notice. Proceedings for any such denial, suspension, or revocation hearing shall be governed by the "State Administrative Procedure Act", article 4 of title 24, C.R.S.; except that the secretary of state shall promulgate rules to provide for expedited deadlines to govern such proceedings and shall bear the burden of proof. The status quo concerning the ability of the aggrieved party

to solicit funds shall be maintained during the pendency of the proceedings. Judicial review shall be available pursuant to section 24-4-106, C.R.S.

(c) In addition to other remedies authorized by law, the secretary of state may bring a civil action in the district court of any judicial district in which venue is proper for the purpose of obtaining injunctive relief against any person who violates, or threatens to violate, the provisions of this article.

(d) The rights and remedies available to the secretary of state pursuant to this subsection (6) shall not affect the rights and remedies available to any other person seeking relief for violations of this article or any other applicable law.

Source: L. 88: Entire article added, p. 357, § 1, effective July 1. **L. 89:** (1)(a) and (1)(e) amended, p. 367, § 7, effective July 1. **L. 93:** (5) added, p. 1575, § 8, effective July 1. **L. 2001:** IP(1) and (3) amended and (1)(h), (1)(i), (1)(j), (1)(k), (1)(l), (1)(m), (1)(n), (1)(o), (1)(p), (1.5), and (6) added, pp. 1247, 1248, §§ 7, 8, effective May 9, 2002. **L. 2004:** (2) and (3) amended, p. 1188, § 9, effective August 4.

Editor's note: Prior to its repeal in 1988, provisions concerning charitable fraud were found in § 18-5-115.

ANNOTATION

Former statute unconstitutional. Former statute regarding charitable solicitations fraud, § 18-5-115 (1)(a), declared unconstitutionally overbroad because speech pertaining to charitable solicitation is entitled to the highest constitutional protection and is subject to strict scrutiny, and may be regulated only when regulation is narrowly tailored to achieve compelling state interest. Statute was not narrowly drawn because less intrusive means of preventing fraud were available. People v. French, 762 P.2d 1369 (Colo. 1988).

6-16-111.5. Investigations. Whenever the secretary of state or the secretary of state's designee believes that a violation of this article has occurred, the secretary of state or the secretary of state's designee may investigate any such violation. Upon demand, records shall be made available and produced to the secretary of state for inspection. Such records shall not be subject to disclosure pursuant to part 2 of article 72 of title 24, C.R.S.; except that public records about persons subject to this article prepared by the secretary of state or the secretary of state's designee are subject to disclosure pursuant to part 2 of article 72 of title 24, C.R.S.

Source: L. 2008: Entire section added, p. 807, § 4, effective September 1.

6-16-112. Service of process. Any foreign corporation performing any of the acts prohibited under this article through any salesman or agent is subject to service of process either upon the registered agent specified by said corporation or upon the corporation itself if no agent is maintained pursuant to part 7 of article 90 of title 7, C.R.S. Service of process upon any individual outside this state based upon any action arising out of matters prohibited by this article shall be pursuant to section 13-1-125, C.R.S.

Source: L. 88: Entire article added, p. 358, § 1, effective July 1. **L. 93:** Entire section amended, p. 853, § 2, effective July 1, 1994. **L. 2003:** Entire section amended, p. 2356, § 345, effective July 1, 2004.

6-16-113. Severability. If any provision of this article is found by a court of competent jurisdiction to be unconstitutional, the remaining provisions of this article shall be valid, unless it appears to the court that the valid provisions of this article are so essentially and inseparably connected with, and so dependent upon, the void provision that it cannot be presumed that the general assembly would have enacted the valid provisions without the

void provision or unless the court determines that the valid provisions, standing alone, are incomplete and are incapable of being executed in accordance with the legislative intent.

Source: L. 88: Entire article added, p. 358, § 1, effective July 1.

6-16-114. Fine - late filing fee - rules. Any charitable organization, professional fund-raising consultant, or paid solicitor who, after sufficient notification by the secretary of state, fails to properly register, renew a registration, file a solicitation notice, or file a financial report of a solicitation campaign under this article by the end of the seventh day following the issuance of the final notice, is liable for a fine or late filing fee in an amount to be established by rule promulgated by the secretary of state. The late fee for filing a registration renewal, solicitation notice, or solicitation campaign financial report late shall not exceed one hundred dollars per year for charities or two hundred dollars per year for paid solicitors. Sufficient notification consists of at least two notices given to the organization and registered agent of the charitable organization, professional fund-raising consultant, or paid solicitor. The fine or late filing fee is in addition to any other filing fee provided by this article.

Source: L. 2008: Entire section added, p. 807, § 4, effective September 1. **L. 2010:** Entire section amended, (HB 10-1403), ch. 404, p. 1993, § 1, effective August 11.

RECORDS RETENTION

ARTICLE 17

Uniform Records Retention Act

6-17-101. Short title. This article shall be known and may be cited as the "Uniform Records Retention Act".

Source: L. 90: Entire article added, p. 384, § 1, effective July 1.

6-17-102. Legislative declaration. The general assembly hereby finds that there is a need to minimize the paperwork burden associated with the retention of business records for individuals, small businesses, state and local agencies, corporations, and other persons, and there is a need to minimize the costs of collecting, maintaining, using, storing, and disseminating information and business records. The general assembly therefore finds that the provisions of this article are necessary to promote efficiency and economy.

Source: L. 90: Entire article added, p. 384, § 1, effective July 1.

6-17-103. Definitions. As used in this article, unless the context otherwise requires:

(1) "Business record" means books of account; vouchers; documents; cancelled checks; payrolls; correspondence; records of sales, personnel, equipment, and production; reports relating to any or all of such records; and other business papers.

(2) "Record" means any letter, word, sound, number, or its equivalent, set down by handwriting, typewriting, printing, photostating, photographing, magnetic impulse, mechanical, or electronic recording of other forms of data compilation. Unless otherwise specified, reproductions are records for purposes of this article.

(3) "Reproduction" means any counterpart produced by the same impression as the original or from the same matrix, or by means of photography, including enlargements and

miniatures, or by mechanical or electronic rerecording or by chemical reproduction or by any equivalent technique which accurately reproduces the original.

Source: L. 90: Entire article added, p. 384, § 1, effective July 1.

6-17-104. Records retention period. Any record required to be created or kept by any state or local law or regulation may be destroyed after three years from the date of creation, unless such law or regulation establishes a specified records retention period or a specific procedure to be followed prior to destruction.

Source: L. 90: Entire article added, p. 385, § 1, effective July 1.

6-17-105. Form of record. Retention of reproductions produced pursuant to this article shall constitute compliance with any state or local law requiring that any record be created or kept.

Source: L. 90: Entire article added, p. 385, § 1, effective July 1.

6-17-106. Scope of article. This article shall apply to all records prepared by private individuals, partnerships, corporations, or any other association, whether carried on for profit or not, and to any government entity operating under the laws of this state and shall apply to all records created before and after July 1, 1990.

Source: L. 90: Entire article added, p. 385, § 1, effective July 1.

HEALTH CARE COVERAGE COOPERATIVES

ARTICLE 18

Health Care Coverage Cooperatives - Provider Networks

Editor's note: Parts 1, 2, and 4 of this article were relocated to part 10 of article 16 of title 10 in 2004.

Cross references: For general provisions relating to health care insurance, see article 16 of title 10.

Law reviews: For article, "H.B. 94-1193: Health Care Purchasing Reform", see 23 Colo. Law. 2763 (1994).

PART 1

GENERAL PROVISIONS

6-18-101 to 6-18-103. (Repealed)

Source: L. 2004: Entire part repealed, p. 1011, § 23, effective August 4.

Editor's note: This article was added in 1994, and this part 1 was subsequently repealed in 2004. For amendments to this part 1 prior to its repeal in 2004, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

PART 2

HEALTH CARE COVERAGE COOPERATIVES

6-18-201 to 6-18-208. (Repealed)

Source: L. 2004: Entire part repealed, p. 1011, § 23, effective August 4.

Editor's note: (1) This article was added in 1994, and this part 2 was subsequently repealed in 2004. For amendments to this part 2 prior to its repeal in 2004, consult the Colorado statutory research explanatory note and the table itemizing the replacement volumes and supplements to the original volume of C.R.S. 1973 beginning on page vii in the front of this volume.

(2) Section 6-18-206 (1)(e) and (2)(c) were amended in Senate Bill 04-239. Those amendments were superseded by the repeal of this part 2 in Senate Bill 04-105.

PART 3

PROVIDER NETWORKS

6-18-301. Legislative declaration. (1) The general assembly hereby finds, determines, and declares that the rapidly changing health care market provides unique opportunities for health care providers to organize themselves into new forms of collaborative systems to deliver high quality health care at competitive market prices to cooperatives and other purchasers. This part 3 is enacted to encourage such collaborative arrangements and to further market-based competition among health care providers.

(2) The general assembly further recognizes that in order to achieve the most effective use of resources and medical technology to respond to changing market conditions, providers who would otherwise be competitors with each other will need to horizontally integrate in order to develop collaborative arrangements to guarantee an adequate number of providers to service the market and to vertically integrate in order to guarantee that those who receive services will have a continuum of care as appropriate to their care needs.

(3) The general assembly also recognizes that to effect such new forms of collaborative systems and integration of providers to service the market will require an analysis of existing methods of providing services, contracting, collaborating, and networking among providers and the extent and type of regulatory oversight of licensed provider networks or licensed individual providers which is appropriate to protect the public.

Source: L. 94: Entire article added, p. 1937, § 1, effective July 1.

6-18-301.5. Definitions. As used in this part 3, unless the context otherwise requires:

(1) "Licensed provider network" or "licensed individual provider" means a provider network or individual provider that is authorized to transact insurance business pursuant to title 10, C.R.S.

(2) "Provider" means a state-licensed, state-certified, or state-authorized facility or a practitioner delivering health care services to individuals.

(3) "Provider network" means a group of health care providers formed to provide health care services to individuals.

Source: L. 2004: Entire section added, p. 1009, § 17, effective August 4.

6-18-302. Creation of provider networks - requirements. (1) (a) Providers are hereby authorized to conduct business collaboratively as provider networks. Such networks are entities existing on or before July 1, 1994, that meet the definition of a provider network or may be created as any lawful entity under title 7, C.R.S., or as otherwise allowed by law. Provider networks existing on or before July 1, 1994, and provider networks created on and after July 1, 1994, conducting business pursuant to this part 3, in addition to the matters otherwise required, shall be subject to this article.

(b) (I) Except as provided in subparagraph (II) of this paragraph (b), if a provider network or individual provider organized on or after July 1, 1994, or organized prior to said date, proposes or is engaged in the transaction of insurance business, as defined in section 10-3-903, C.R.S., or the activities of a health maintenance organization as defined in section 10-16-102 (23), C.R.S., such provider network or individual provider must hold a certificate of authority from the commissioner of insurance to do business as an insurance company under title 10, C.R.S., or to establish a health maintenance organization under section 10-16-402, C.R.S.

(II) The fact that a provider network or individual provider has a capitated contract or other agreement with a carrier, pursuant to which the provider network or individual provider shares some of the risk of providing services to groups or individuals covered under a health care coverage plan issued by a carrier, shall not, in and of itself, be grounds for a determination by the commissioner of insurance that the provider network or individual provider is engaged in the transaction of insurance business.

(III) The commissioner of insurance, in consultation with providers and other appropriate persons, shall evaluate the need for specific legislation or rules for the licensure of provider networks and individual providers and, if determined appropriate, shall make recommendations thereon to the general assembly and governor and shall adopt such rules that are specific to licensed provider networks and licensed individual providers as provided in section 10-1-108 (13), C.R.S. A licensed provider network or licensed individual provider shall be subject to applicable provisions of title 10, C.R.S., except as otherwise provided in statute or rule adopted pursuant to section 10-1-108 (13), C.R.S.

(IV) Every licensed provider network that conducts insurance business in the state of Colorado shall:

(A) Obtain from the commissioner of insurance, before the start of business, a certificate of authority authorizing the provider network to conduct business in the state of Colorado;

(B) Maintain its principal and home office in the state of Colorado, maintain such books and records in this state, and maintain principal banking relationships with a bank chartered by the state of Colorado or a member bank of the federal reserve system;

(C) Hold at least one board of directors' meeting each year in the state of Colorado;

(D) Include in the provider network's management and administrative agreements, for essential insurance services, a provision that allows the commissioner reasonable access to examine such books and records; and

(E) For purposes of this paragraph (b), substantially perform in the state of Colorado the essential functions of the licensed provider network's principal and home office, including, but not limited to, the provision and administration of health care services, the issuance of health care plans, the maintenance of health care provider relations, and the provision of consumer information and services.

(2) If applicable, a network organized on and after July 1, 1994, is organized when the articles of organization are filed by the secretary of state or, if a delayed effective date is specified in the articles as filed with the secretary of state and a certificate of withdrawal is

not filed, on such delayed effective date. The existence of the network begins upon organization.

(3) If applicable, each provider network shall file a report pursuant to section 7-136-107, C.R.S., and pay a fee to the secretary of state which shall be determined and collected pursuant to section 24-21-104 (3), C.R.S., in lieu of all franchise or corporation license taxes.

(4) A provider network or individual provider may request that specified information submitted to the division of insurance be kept confidential because it is a trade secret as defined in section 7-74-102 (4), C.R.S. The division shall honor such request unless the commissioner determines that the information is already public knowledge or that its confidentiality would be contrary to the public interest or the provider subsequently authorized the commissioner to release such information.

Source: L. 94: Entire article added, p. 1937, § 1, effective July 1. **L. 97:** (3) amended, p. 756, § 6, effective July 1, 1998. **L. 2001:** (1)(b)(IV) added, p. 13, § 1, effective March 1. **L. 2003:** (1)(b)(III) amended, p. 614, § 3, effective July 1. **L. 2004:** (1)(b)(II) amended, p. 979, § 1, effective August 4.

6-18-303. Effect on scope of practice - limited exception to prohibitions on corporate practice of licensed health care providers. (1) Except as provided in subsection (2) of this section, the fact that an entity or provider is a member of a provider network shall not exempt such entity or provider from any licensure or regulatory statute, nor shall any scope of practice of any provider be expanded, reduced, or otherwise modified by virtue of membership in or affiliation with any provider network.

(2) Any provision of article 29.5, 32, or 33 of title 12, C.R.S., or any of the provisions of articles 35, 36, and 38 to 43 of title 12, C.R.S., prohibiting the practice of any licensed or certificated health care profession as the partner, agent, or employee of or in joint venture with a person who does not hold a license or certificate to practice such profession within this state shall not apply to professional practice if a professional is participating in a provider network organized pursuant to this part 3 and:

(a) The partnership, agency, employment, or joint venture is evidenced by a written agreement containing language to the effect that the relationship created by the agreement may not affect the exercise of the licensed or certified professional's independent judgment in the practice of the profession;

(b) The licensed or certificated professional's independent judgment in the practice of such profession is in fact unaffected by the relationship; and

(c) The licensed professional is not required to exclusively refer any patient to a particular provider or supplier or take any other action the licensed professional determines not to be in the patient's best interest.

Source: L. 94: Entire article added, p. 1938, § 1, effective July 1.

6-18-304. Competitive behavior - restraints of trade prohibited. Organization or operation as a provider network is authorized under this article for the purpose of more cost-effective delivery of health care services, and shall not be construed as permitting any such collaborative system or any member of such provider network to act in a concerted way to restrain trade or otherwise engage in practices which are otherwise prohibited by federal or state antitrust law.

Source: L. 94: Entire article added, p. 1939, § 1, effective July 1.

ANNOTATION

Law reviews. For article, "Physician-Controlled Network Joint Ventures: Antitrust Considerations", see 24 Colo. Law. 1551 (1995).

PART 4

TECHNICAL ASSISTANCE TO AUTHORIZED COOPERATIVES FROM DEPARTMENT OF HEALTH CARE POLICY AND FINANCING

6-18-401. (Repealed)

Source: L. 2004: Entire part repealed, p. 1011, § 23, effective August 4.

Editor's note: This article was added in 1994, and this part 4 was not amended prior to its repeal in 2004. For the text of this part 4 prior to 2004, consult the 2003 Colorado Revised Statutes.

TRANSACTIONS INVOLVING LICENSED HOSPITALS

ARTICLE 19

Transactions Involving Licensed Hospitals

Law reviews: For article, "Attorney General Review of Asset Transfers by Nonprofit Hospitals", see 28 Colo. Law. 37 (February 1999).

PART 1

GENERAL PROVISIONS

6-19-101. Legislative declaration. (1) The general assembly hereby finds, determines, and declares that all licensed and certified hospitals provide a service to the public by making health care services available to the communities they serve.

(2) Furthermore, for purposes of the attorney general's authority over the transfer of nonprofit hospital assets, all nonprofit hospitals shall be deemed to hold all of their assets in trust, and those assets shall be deemed to be dedicated to the specific charitable purposes set forth in the articles of incorporation or other organic documents of the nonprofit entities that hold them in trust. The public is the beneficiary of this trust. Nonprofit hospitals have a substantial and beneficial effect on the provision of health care to the people of Colorado, providing as part of their charitable purposes uncompensated care to the uninsured or underinsured and including, but not limited to, providing moneys and support for health-

related research and education or other community benefits. The general assembly also finds that transfers of the assets of nonprofit hospitals to the for-profit sector may directly affect the character and extent of the charitable use of those assets or the proceeds from the assets. The public also has an interest in knowing that the transfer of the assets of a nonprofit hospital, or the proceeds from the assets, preserves, to the extent practicable, their charitable purpose. The general assembly believes it is in the best interest of the public to ensure that the public interest is fully protected whenever the assets of a hospital are transferred to a for-profit entity except in the ordinary course of business.

(3) The general assembly further finds and declares that all transfers of hospital assets or control have the potential to impact the communities they serve. This article is intended to protect the public interest, to assure that nonprofit assets of hospitals are preserved to serve the charitable purposes to which they were dedicated, and to provide the public notice of all transfers of assets of hospitals that constitute covered transitions as defined in this article and shall be construed with these purposes in mind.

(4) The general assembly further finds and declares that the addition of the factors to be considered in relation to the term "material change" in section 6-19-203 (1) is intended to clarify the provisions of this article.

Source: L. 98: Entire article added, p. 520, § 1, effective April 30. **L. 2008:** (4) added, p. 1342, § 1, effective August 5.

6-19-102. Definitions. As used in this article, unless the context otherwise requires:

(1) "Covered transaction" means any transaction that would result in the sale, transfer, lease, exchange, or other disposition of fifty percent or more of the assets of a hospital. A series of transactions taking place in any five-year period, which would result in the aggregate of the transfer of fifty percent or more of a hospital's assets, shall in all circumstances be deemed to be a covered transaction. "Covered transaction" shall also include the sale, transfer, or other disposition of the control of a parent company, holding company, or other entity controlling a hospital. For the purposes of this subsection (1), "fifty percent or more of the assets" shall be based on the fair market value of all of the assets of the hospital.

(2) "For-profit entity" means a business corporation, general partnership, limited partnership, limited liability limited partnership, limited liability partnership, limited liability company, limited partnership association, and cooperative.

(3) "Hospital" means a licensed or certified hospital as described in section 25-1.5-103 (1) (a) (I) and (1) (a) (II), C.R.S.

Source: L. 98: Entire article added, p. 521, § 1, effective April 30. **L. 2003:** (3) amended, p. 700, § 4, effective July 1.

6-19-103. Procedures for covered transactions - notice - attorney general powers. (1) The parties to a covered transaction shall provide notice of such transaction to the attorney general no later than sixty days prior to the transaction closing or effective date of the transaction. The notice to the attorney general shall be in writing, shall include the information required in section 6-19-202, 6-19-302, or 6-19-402, as applicable, and shall contain a certification that public notice of the transaction will be given within seven days after the notification to the attorney general.

(2) Whenever the attorney general has reason to believe that a person has engaged in or is engaging in a covered transaction without complying with the provisions of this article, the attorney general may apply for and obtain, in an action in the appropriate district court of this state, a temporary restraining order or injunction, or both, pursuant to the Colorado rules of civil procedure prohibiting such person from continuing such noncompliance or engaging therein or doing any act in furtherance thereof. The court may make such further orders or judgments, at law or in equity, as may be necessary to remedy such noncompliance.

Source: L. 98: Entire article added, p. 521, § 1, effective April 30.

6-19-104. Attorney general - affect on powers. (1) Nothing in this article shall be construed as limiting the attorney general's common law powers.

(2) Nothing in this article shall affect the regulatory authority of any government agency other than the department of law.

Source: L. 98: Entire article added, p. 522, § 1, effective April 30.

PART 2

NONPROFIT TO NONPROFIT TRANSACTIONS

6-19-201. Scope of part 2. This part 2 applies to covered transactions involving a nonprofit hospital and another nonprofit entity.

Source: L. 98: Entire article added, p. 522, § 1, effective April 30.

6-19-202. Notice. Notice shall be provided by the parties to a covered transaction according to section 6-19-103 and shall include a statement on the charitable purposes of each nonprofit entity entering into the covered transaction as well as a statement concerning the relationship of these purposes to the hospital involved in the transaction. The statement may include a certification by the chief executive officer as approved by the board of directors or board of trustees of the nonprofit entity transferring its assets that there will be no material change in the charitable purposes to which the transferred assets are dedicated as a result of the transaction.

Source: L. 98: Entire article added, p. 522, § 1, effective April 30.

6-19-203. Attorney general review and assessment. (1) A covered transaction under this part 2 that will not result in a material change in the charitable purposes to which the assets of the hospital have been dedicated, and will not result in a termination of the attorney general's jurisdiction over those assets caused by a transfer of a material amount of those assets outside of the state of Colorado, shall proceed without further review. In considering whether a material change results from the transaction, the attorney general shall consider, among other factors, reductions in the availability and accessibility of health care services in the communities served by the hospital.

(2) When a transaction covered by this part 2 will result in a material change in the charitable purposes to which the assets of the hospital have been dedicated, or a termination of the attorney general's jurisdiction over the hospital assets caused by a transfer of a material amount of those assets outside the state of Colorado, the attorney general may exercise his or her common law authority to assess and review or challenge the transaction as deemed appropriate by the attorney general. If the attorney general decides to conduct an assessment or review the following provisions shall apply to such actions of the attorney general:

(a) The attorney general shall perform a review and assessment to the extent practicable and with due consideration to the financial circumstances of the parties to the transaction. The attorney general is further authorized to:

(I) Hire experts, at the expense of the parties to the transaction, as similarly provided for in section 6-19-406 (1) (b) and to accept and expend grants or donations, or both, as similarly provided for in section 6-19-406 (1) (e);

(II) Contract and consult with other state agencies as similarly provided for in section 6-19-406 (1) (a);

(III) Require production of material documentation, such as the proposed agreements relating to the proposed transaction, agreements regarding collateral transactions relating to the proposed transaction, and any reports of financial and economic analysis that the nonprofit entity reviewed or relied on in negotiating the proposed transaction. These documents shall be treated in the same manner as set forth in section 6-19-404 (4).

(IV) Hold a public hearing as similarly provided for in section 6-19-404 (1). The attorney general shall provide a written determination within the time frames or extended time frames as similarly provided for in section 6-19-402 (2).

(b) The attorney general shall have the authority to allow a transaction that satisfies the following criteria:

(I) The assets continue to be dedicated to charitable purposes;

(II) The directors or trustees of the parties to the transaction have not acted unreasonably in light of the financial circumstances of the parties;

(III) The directors or trustees of the parties to the transaction have not acted unreasonably in accommodating the affected community or communities; and

(IV) The directors or trustees of the parties to the transaction have not breached their fiduciary duties or otherwise engaged in misconduct in such transaction.

(c) The attorney general shall liberally construe the criteria set forth in paragraph (b) of this subsection (2) in favor of allowing a transaction to proceed.

Source: L. 98: Entire article added, p. 522, § 1, effective April 30. **L. 2008:** (1) amended, p. 1342, § 2, effective August 5.

PART 3

FOR-PROFIT TO FOR-PROFIT TRANSACTIONS

6-19-301. Scope of part 3. This part 3 applies to covered transactions where the parties involved in the transaction are all for-profit entities.

Source: L. 98: Entire article added, p. 524, § 1, effective April 30.

6-19-302. Notice. The parties to a covered transaction governed by this part 3 shall provide the notice required by section 6-19-103.

Source: L. 98: Entire article added, p. 524, § 1, effective April 30.

PART 4

NONPROFIT TO FOR-PROFIT TRANSACTIONS

6-19-401. Scope of part 4. This part 4 applies to covered transactions involving a nonprofit hospital and a for-profit entity.

Source: L. 98: Entire article added, p. 524, § 1, effective April 30.

ANNOTATION

Law reviews. For article, "Colorado Choice of Entity 1998", see 27 Colo. Law. 5 (June 1998).

6-19-402. Notice and filing. (1) The notice and filing provided to the attorney general pursuant to section 6-19-103 shall include all proposed agreements relating to the proposed transaction, all agreements regarding collateral transactions that relate to the principal transaction, any reports of financial and economic analysis that the nonprofit entity reviewed or relied on in negotiating the proposed transaction, and an explanation of how the completed transaction will comply with the requirements of section 6-19-403. The attorney general shall notify the parties to the transaction if the filing is complete or incomplete within thirty days after the initial filing and shall specify the omitted documentation if incomplete. An initial filing that includes a schedule for the submission of subsequently produced or acquired documents may be deemed complete by the attorney general.

(2) Within sixty days after the complete filing required by this section, the attorney general shall notify in writing the parties to the transaction of the results and conclusions of the review and assessment. The attorney general may extend this period for an additional period of up to ninety days if the attorney general determines, for good cause, that additional time is warranted and so advises the parties in writing. The attorney general shall notify the parties of any extension as soon as possible.

Source: L. 98: Entire article added, p. 524, § 1, effective April 30.

6-19-403. Certification and criteria. (1) The proposed transaction shall comply with the provisions of this section, and the parties to the transaction shall include in the filing required by section 6-19-402 documentation and certification from the parties, either joint or several as appropriate, that the covered transaction will comply with the following:

(a) The transaction shall be in the public interest. A transaction is not in the public interest unless appropriate steps have been taken to safeguard the value of nonprofit hospital assets being transferred and to ensure that any proceeds of the transaction are dedicated to the charitable purposes.

(b) The transaction results in continuing access to health care services for the affected community.

(c) No director, officer of the board, chief executive officer, chief operating officer, or chief financial officer of the nonprofit entity submitting the filing or a nonprofit charitable organization receiving the proceeds of the covered transaction shall benefit directly or indirectly from the transaction.

(d) The nonprofit entity proposing the transaction shall use due diligence in selecting the for-profit entity that is a party to the transaction and in negotiating the price and other terms and conditions of the transaction.

(e) Proceeds of the covered transaction shall be set aside in an amount equal to the fair market value of the hospital assets being transferred. Fair market value shall be determined at the time of the transaction and include consideration of market value, going concern value, net asset value, and any other significant relevant factors.

(f) The distribution of the proceeds of the covered transaction shall be made only to one or more existing or new charitable organizations operating pursuant to 26 U.S.C. sec. 501 (c) (3) of the federal "Internal Revenue Code of 1986", as amended.

(g) Each nonprofit charitable organization receiving the proceeds of the covered transaction, its directors, officers, and staff shall be and remain independent of the parties to the transaction and their affiliates. Except as provided in this paragraph (g), no person who is a director, officer of the board, chief executive officer, chief operating officer, or chief financial officer of any party to the transaction submitting the notice and filing, at the time the notice is submitted or at the time of the transaction, shall be qualified to be an officer of the board, chief executive officer, chief operating officer, or chief financial officer of the nonprofit charitable organization receiving the proceeds of the covered transaction. The nonprofit entity that is a party to the proposed transaction shall include in its notice and filing the proposed membership of the initial board of directors of the nonprofit charitable organization that is to receive the proceeds of the covered transaction that shall represent the diverse interests of the affected communities and include persons from the area affected by the transaction. Notwithstanding the requirements of this paragraph (g), each nonprofit charitable organization receiving the proceeds of the covered transaction may have persons affiliated with parties to the transaction or their affiliates serve on its board of directors provided that such persons do not constitute more than one-third of the members of the board.

(h) A nonprofit charitable organization receiving the proceeds of the covered transaction shall put mechanisms in place to avoid conflicts of interest and to prohibit grants or other actions benefiting its board of directors or management beyond the reasonable value of their services or substantially benefiting the for-profit entity.

(i) The charitable mission and functions of the nonprofit charitable organization receiving the proceeds of the covered transaction shall reflect the historical charitable purposes of the nonprofit entity proposing the transaction.

Source: L. 98: Entire article added, p. 524, § 1, effective April 30.

6-19-404. Attorney general review. (1) No later than thirty days after the attorney general has received the completed notice and filing pursuant to section 6-19-402, the attorney general shall hold at least one public hearing in the service area of the hospital involved in the transaction, at which the attorney general shall allow any person to either file written comments and exhibits or appear and make a statement about any aspect of the transaction, including, but not limited to, whether the proposed transaction complies with the requirements of section 6-19-403. At least seven days prior to each public hearing, the attorney general shall submit a press release providing pertinent information about the hearing, including the time and place of the hearing, to one or more newspapers of general circulation in the affected communities and notify the mayor of the city or city and county and the board of county commissioners of the county in which the hospital is located. The public hearing shall be a legislative rather than an adjudicative hearing.

(2) The attorney general shall have the power to subpoena documents or witnesses, require and administer oaths, and require statements at any time that are reasonably necessary to assess an application or monitor compliance with this section.

(3) If any person fails to cooperate with any investigation pursuant to this section or fails to obey any subpoena issued pursuant to this section, the attorney general may apply to the appropriate district court for an appropriate order to effect the purposes of this section. The application shall state that there are reasonable grounds to believe that the order applied for is necessary to carry out the attorney general's duties under this section. If the court is satisfied that reasonable grounds exist, the court, in its order, may:

(a) Require the attendance of or the production of documents by such person, or both;

(b) Grant such other or further relief as may be necessary to obtain compliance by such person.

(4) Except for documents the attorney general determines to be confidential as a matter of law, the documents filed pursuant to section 6-19-402 shall be available to the public for review and copying during normal business hours at both the attorney general's office and the offices of the parties to the transaction. Reasonable costs of copying shall be borne by the parties if copies are requested at their offices.

Source: L. 98: Entire article added, p. 526, § 1, effective April 30.

6-19-405. Post-transaction requirements. For a period of not less than five years, the nonprofit charitable organization receiving the proceeds of the covered transaction shall provide the attorney general with an annual report of its grant-making and other charitable activities related to its use of the proceeds of the covered transaction received. For a period of not less than five years, the for-profit entity shall provide the attorney general with an annual report detailing its activities to satisfy the requirements of section 6-19-403 at the time of the review and assessment. These annual reports shall be made available to the public at the attorney general's office, the office of the nonprofit charitable organization, and the offices of the parties to the covered transaction. The annual report shall be filed no later than ninety days after the year that the report addresses.

Source: L. 98: Entire article added, p. 527, § 1, effective April 30.

6-19-406. Attorney general powers. (1) The attorney general has the following powers:

(a) To contract with, consult with, and receive advice from any state agency on those terms and conditions that the attorney general and the executive director deem appropriate;

(b) To contract with persons including, but not limited to, attorneys, accountants, actuaries, financial analysts, and health care analysts as is reasonable and necessary to assist in reviewing a proposed transaction. Contract costs shall be borne by the parties to the transaction and shall not exceed an amount that is reasonably necessary to conduct the review and assessment.

(c) To adopt regulations or guidelines as necessary in order to carry out the requirements of this section;

(d) The discretion to determine, consistent with the requirements of section 6-19-404, the degree of administrative review of the transaction that is necessary to determine whether the transaction conforms with the requirements of section 6-19-403. This determination shall be made by taking into consideration, among other things, the size of the transaction, the size of all communities affected by the transaction, the impact on the communities, and the past performance of the for-profit entity.

(e) To accept and expend grants or donations, or both, not to exceed fifty thousand dollars for the purpose of the implementation of this article. Any such grants or donations shall be deposited into and expended from the nonprofit health care entity review cash fund created in paragraph (f) of this subsection (1).

(f) To request and receive from the for-profit entity such sums as may be prescribed by the attorney general to cover the necessary and actual costs for monitoring for the ensuing five-year period to ensure that the transaction remains in compliance with the requirements of section 6-19-403. Any moneys collected pursuant to this paragraph (f) shall be transmitted to the state treasurer, who shall credit the same to the nonprofit health care entity review cash fund, which fund is hereby created in the state treasury. The moneys in such fund shall be continuously appropriated for the direct and indirect costs of such monitoring. In accordance with section 24-36-114, C.R.S., all interest derived from the deposit and investment of this fund shall be credited to the general fund.

(g) To hold a hearing after twenty days' notice to the affected parties if the attorney general receives information that the attorney general deems sufficient to indicate that the nonprofit charitable organization or for-profit entity may not be fulfilling its obligations pursuant to section 6-19-403. If, after such hearing, the attorney general determines that proof of the noncompliance is probable, he or she shall institute proceedings in district court to require corrective action. The attorney general shall retain oversight of the corrective action for as long as necessary to ensure compliance. Nothing in this section shall be construed to limit the attorney general's power to enforce compliance with this section after the expiration of the five-year period contemplated by paragraph (f) of this subsection (1).

Source: L. 98: Entire article added, p. 527, § 1, effective April 30.

6-19-407. Attorney general review and assessment. (1) The attorney general may review any notice and filing made under this part 4 and assess whether the proposed transaction complies with the requirements of section 6-19-403.

(2) If, after review and assessment, the attorney general concludes that all of the requirements of section 6-19-403 have been met, the attorney general shall issue a written assessment and conclusion to such effect on the proposed transaction. If the attorney general concludes, after discussions with the parties to the transaction, that all of the requirements of section 6-19-403 have not been met, or if the attorney general is unable to conclude whether or not all of the requirements of section 6-19-403 have been met, the attorney general shall issue a written assessment and conclusion to such effect on the proposed transaction. Such nonconclusive or noncomplying assessment and conclusion shall include specific findings on each of the requirements of section 6-19-403. The attorney general may also issue a written statement that a formal assessment and review has not been determined necessary for the covered transaction or that the transaction does not constitute a covered transaction.

(3) The attorney general may challenge any proposed transaction at any time through injunction, declaratory order, or otherwise, in the district court of the jurisdiction in which the nonprofit entity proposing the transaction has its principal place of business or where the hospital involved in the transaction is located. If the attorney general's assessment and

review under this section is challenged in court, the attorney general's conclusions shall be the focus of the review by the reviewing court and shall be given strong deference by such court. The burden shall be upon the proponents of the transaction to establish that the attorney general's conclusions are not in conformance with statutory provisions. The court shall have the power to issue whatever orders are necessary to ensure compliance with the provisions of section 6-19-403.

Source: L. 98: Entire article added, p. 528, § 1, effective April 30.

ARTICLE 20

Hospital Disclosures to Consumers

PART 1

DISCLOSURE OF AVERAGE CHARGE

6-20-101. Provider disclosure of average charge. (1) Each hospital licensed or certified pursuant to section 25-1.5-103 (1) (a), C.R.S., shall disclose to a person seeking care or treatment his or her right to receive notice of the average facility charge for such treatment that is a frequently performed inpatient procedure prior to admission for such procedure; except that care or treatment for an emergency need not be disclosed prior to such emergency care or treatment. When requested, the average charge information shall be made available to the person prior to admission for such procedure.

(2) Other health facilities licensed or certified pursuant to section 25-1.5-103 (1) (a), C.R.S., shall disclose to a person seeking care or treatment his or her right to receive notice of the average facility charge for such treatment that is a frequently performed procedure prior to ordering or scheduling such procedure; except that care or treatment for an emergency need not be disclosed prior to such emergency care or treatment. When requested, such average charge information shall be made available to the person prior to the scheduling of the procedure.

Source: L. 2003: Entire article added, p. 1221, § 2, effective January 1, 2004. **L. 2004:** (1) and (2) amended, p. 1189, § 11, effective August 4.

PART 2

NOTIFICATION OF DEBT BY A HEALTH CARE PROVIDER

6-20-201. Definitions. For the purposes of this part 2, unless the context otherwise requires:

(1) "Collection activity" means only those activities provided or performed by a licensed collection agency, using a business name other than the name of the health care provider, for purposes of collecting a debt. The term does not include any standard billing procedures used by the health care provider or its agent in the normal course of business on current, nondelinquent accounts.

(2) "Collection agency" shall have the same meaning as in section 12-14-103 (2), C.R.S.

(3) "Health care provider" includes a health care facility licensed pursuant to article 3 of title 25, C.R.S., and any other health care provider.

Source: L. 2004: Entire part added, p. 458, § 1, effective August 4. **L. 2005:** Entire section amended, p. 124, § 1, effective August 8.

6-20-202. Notice to patient of debt. (1) (a) When a person has health benefit coverage to provide payment for care or treatment rendered by a health care provider and the person has notified the health care provider of coverage within thirty days after the date the care or treatment was rendered, and if the health coverage plan, as defined in section 10-16-102 (22.5), C.R.S., pays only a portion of the debt, prior to the assignment of the debt to a licensed collection agency, the health care provider shall mail written notice to the last-known address of the person responsible for payment of the debt at least thirty days before any collection activity on any amount due and owing the health care provider.

(b) The notice required of health care providers by paragraph (a) of this subsection (1) shall include the amount due and owing; the name, address, and telephone number of the health care provider; where payment may be made; the date of service; and the last date or number of days after the date of the notice the health care provider will accept payment prior to the debt being submitted to a collection agency or reporting adverse information to a consumer reporting agency for the debt for which notice was provided.

(2) (a) If the health care provider fails to provide the person with notice of such debt and all other information required by subsection (1) of this section, the health care provider shall not pursue any rights to collect such outstanding amount either through a collection agency or by any further efforts of the health care provider to collect the debt. In addition, the health care provider may not report adverse information to a consumer reporting agency for the debt for which notice was provided without providing notice to the person pursuant to subsection (1) of this section. The health care provider shall assist the person in correcting any adverse credit information because of the health care provider's failure to provide notice pursuant to subsection (1) of this section.

(b) Notwithstanding any provision of this section to the contrary, a health care provider may remedy a failure to give notice by providing a written report to the collection agency to withhold any collection activity and withholding any of the health care provider's own collection efforts until the provider complies with the notice and time requirements pursuant to subsection (1) of this section.

(c) Nothing in this subsection (2) shall be construed to require a health care provider to perform additional attempts to notify a person of the person's portion of the debt other than mailing the notice required pursuant to subsection (1) of this section to the person's last-known address and maintaining a record of such mailing.

(d) The failure of a health care provider or its agent to provide the notice required by subsection (1) of this section shall not create a cause of action or remedy against a collection agency under the "Colorado Fair Debt Collection Practices Act", article 14 of title 12, C.R.S.

Source: L. 2004: Entire part added, p. 458, § 1, effective August 4. **L. 2005:** (1) and (2)(b) amended and (2)(d) added, p. 124, § 2, effective August 8.

PROTECTION AGAINST EXPLOITATION OF AT-RISK ADULTS

ARTICLE 21

Protection Against Financial Exploitation

6-21-101. Legislative declaration. (1) The general assembly hereby finds that:

(a) Financial exploitation of at-risk adults is an area of significant concern;

(b) At-risk adults comprise an increasingly large segment of society, and the financial exploitation of such persons is occurring at an ever-increasing rate;

(c) Persons committing financial exploitation of at-risk adults may be persons known to the at-risk adult or strangers perpetrating fraudulent schemes, and may be in a position to threaten to withhold care, manipulate, or deceive an at-risk adult;

(d) At-risk adults may not report or prevent financial exploitation due to lack of information, fear, or intimidation;

(e) Financial institutions are in unique positions to acquire early knowledge of financial exploitation by noticing indicators such as sudden changes in bank account activity or banking practices; unexplained withdrawals or atypical transactions involving withdrawals; abrupt changes to wills or other financial documents requested by the at-risk adult; the sudden appearance of previously uninvolved relatives claiming a right to the at-risk adult's affairs and possessions; and unexplained, sudden transfers of assets to a family member of the at-risk adult or another person outside of the at-risk adult's family;

(f) While financial institutions are often in a position to notice indicators of financial exploitation, they may be limited in their ability to release financial records immediately to law enforcement and county departments because of their obligations to maintain confidentiality of bank files and records;

(g) By obtaining a signed prior consent form from account holders who are at-risk adults, financial institutions can cooperate and share vital information with law enforcement and county departments, allowing those entities to respond more quickly to known or suspected instances of financial exploitation of at-risk adults.

(2) Therefore, the general assembly finds and determines that it is appropriate to require financial institutions, which may be in a position to observe indicators of financial exploitation, to offer at-risk adults the option to sign a prior consent form so as to facilitate rapid response from law enforcement and county departments.

Source: L. 2010: Entire article added, (SB 10-042), ch. 383, p. 1788, § 1, effective June 8.

6-21-102. Definitions. As used in this article:

(1) "Account holder" means a person who opens or has an account at a financial institution established primarily for personal, family, or household purposes.

(2) "At-risk adult" has the same meaning as set forth in section 18-6.5-102, C.R.S.

(3) "County department" means a county or district department of social services.

(4) "Eligible account holder" means an account holder who is or becomes, while holding an account at the financial institution, an at-risk adult.

(5) "Financial exploitation" means the illegal or improper use of an at-risk adult's financial resources for another person's profit or advantage.

(6) "Financial institution" means a state or federal bank, savings bank, savings and loan association or company, building and loan association, trust company, or credit union.

Source: L. 2010: Entire article added, (SB 10-042), ch. 383, p. 1789, § 1, effective June 8.

6-21-103. Release of financial information - prior consent - financial exploitation investigations - civil immunity. (1) (a) A financial institution shall offer each eligible account holder, and may offer all account holders, the option to voluntarily sign a prior consent form for placement in the account holder's file or record maintained by the financial institution. The financial institution shall provide notice of the availability of the option, including a description of the purpose of the prior consent as described in paragraph (c) of this subsection (1), when the financial institution establishes a customer relationship with an eligible account holder and at least annually during the continuation of the relationship. The

financial institution may provide the notice required by this subsection (1) in conjunction with the disclosure required by 15 U.S.C. sec. 6803.

(b) By September 1, 2010, the attorney general shall develop, with input from the division of banking and the division of financial services in the department of regulatory agencies, representatives of financial institutions, county departments, local law enforcement, district attorneys, at-risk adults, and other stakeholders, a standard prior consent form that may be used by financial institutions.

(c) By signing a prior consent form, an account holder waives the confidentiality limitations related to his or her financial records maintained at the financial institution for the limited purpose of allowing the financial institution to alert or notify the county department and a local law enforcement agency of known or suspected financial exploitation of the account holder and provide the county department and local law enforcement access to the account holder's records to investigate known or suspected financial exploitation of the account holder.

(d) A prior consent form executed pursuant to this section is effective until the financial institution receives written notice of revocation and survives any disability of the account holder that occurs after the execution of the prior consent form. In the absence of actual knowledge of a judicial determination of incapacity, a financial institution may assume that any account holder that executes a prior consent form has the legal capacity to perform the act.

(2) Nothing in this article or in a signed prior consent form obligates a financial institution to report known or suspected financial exploitation of an account holder.

Source: L. 2010: Entire article added, (SB 10-042), ch. 383, p. 1790, § 1, effective June 8.

RESIDENTIAL ROOFING SERVICES

ARTICLE 22

Roofing Services - Residential Property

Editor's note: Section 2 of chapter 267, Session Laws of Colorado 2012, provides that the act adding this article applies to roofing work performed on residential property in this state on or after June 6, 2012.

6-22-101. Legislative declaration. (1) The general assembly hereby declares that the purpose of enacting this article is to protect Colorado consumers by:

(a) Requiring roofing contractors offering to perform roofing work on residential property in this state to sign a written contract with property owners detailing the scope and cost of the roofing work and contact information for the roofing contractor;

(b) Requiring roofing contractors to permit property owners to rescind a contract for the performance of roofing work and obtain a refund of any deposit paid to the roofing contractor; and

(c) Prohibiting roofing contractors from paying, waiving, rebating, or promising to pay, waive, or rebate all or part of any insurance deductible applicable to an insurance claim made to the property owner's property and casualty insurer for payment for roofing work on the residential property covered by a property and casualty insurance policy.

Source: L. 2012: Entire article added, (SB 12-038), ch. 267, p. 1386, § 1, effective June 6.

6-22-102. Definitions. As used in this article, unless the context otherwise requires:

(1) "Property owner" means the owner of residential property or the owner's legal representative.

(2) (a) "Residential property" means:

(I) A detached, one- or two-family dwelling; or

(II) Multiple single-family dwellings that are not more than three stories above grade plane height and provide separate means of egress.

(b) "Residential property" does not include:

(I) A structure comprising multiple, attached single-family dwellings, unless maintenance, repair, or replacements of the dwellings' roof is the responsibility of a condominium association, homeowners' association, common interest community, unit owners' association, or any other entity subject to the "Colorado Common Interest Ownership Act", article 33.3 of title 38, C.R.S., regardless of when the entity was formed; or

(II) New construction.

(3) "Roofing contractor" means:

(a) An individual or sole proprietorship that performs roofing work or roofing services in this state for compensation; or

(b) (I) A firm, partnership, corporation, association, business trust, limited liability company, or other legal entity that performs or offers to perform roofing work in this state on residential property for compensation.

(II) As used in subparagraph (I) of this paragraph (b), "association" does not include a condominium association, homeowners' association, common interest community, unit owners' association, or any other entity subject to the "Colorado Common Interest Ownership Act", article 33.3 of title 38, C.R.S., regardless of when the entity was formed.

(4) (a) "Roofing work" or "roofing services" means the construction, reconstruction, alteration, maintenance, or repair of a roof on a residential property and the use of materials and items in the construction, reconstruction, alteration, maintenance, and repair of roofing and waterproofing of roofs, all in a manner to comply with plans, specifications, codes, laws, rules, regulations, and roofing industry standards for workmanlike performance applicable to the construction, reconstruction, alteration, maintenance, and repair of roofs on residential properties.

(b) "Roofing work" or "roofing services" does not include roofing work or services for which the compensation is one thousand dollars or less per contract.

Source: L. 2012: Entire article added, (SB 12-038), ch. 267, p. 1387, § 1, effective June 6.

6-22-103. Contracts for roofing services - writing required - required terms. (1) Prior to engaging in any roofing work, a roofing contractor shall provide a written contract to the property owner, signed by both the roofing contractor or his or her designee and the property owner, stating at least the following terms:

(a) The scope of roofing services and materials to be provided;

(b) The approximate dates of service;

(c) The approximate costs of the services based on damages known at the time the contract is entered;

(d) The roofing contractor's contact information, including physical address, electronic mail address, telephone number, and any other contact information available for the roofing contractor;

(e) Identification of the roofing contractor's surety and liability coverage insurer and their contact information, if applicable;

(f) (I) The roofing contractor's policy regarding cancellation of the contract and refund of any deposit, including a rescission clause allowing the property owner to rescind the contract and obtain a full refund of any deposit within seventy-two hours after entering the contract; and

(II) A written statement that the property owner may rescind a roofing contract pursuant to section 6-22-104; and

(g) A written statement that if the property owner plans to use the proceeds of a property and casualty insurance policy issued pursuant to part 1 of article 4 of title 10, C.R.S., to pay for the roofing work, pursuant to section 6-22-105, the roofing contractor cannot pay, waive, rebate, or promise to pay, waive, or rebate all or part of any insurance deductible applicable to the insurance claim for payment for roofing work on the covered residential property.

(2) In addition to the contract terms required in subsection (1) of this section, a roofing contractor shall include, on the face of the contract, in bold-faced type, a statement indicating that the roofing contractor shall hold in trust any payment from the property owner until the roofing contractor has delivered roofing materials at the residential property site or has performed a majority of the roofing work on the residential property.

Source: L. 2012: Entire article added, (SB 12-038), ch. 267, p. 1388, § 1, effective June 6.

6-22-104. Residential roofing contract - payment from insurance proceeds - right to rescind - return of payments. (1) (a) A property owner who enters into a written contract with a roofing contractor to perform roofing work on the property owner's residential property, the payment for which will be made from the proceeds of a property and casualty insurance policy issued pursuant to part 1 of article 4 of title 10, C.R.S., may rescind the contract within seventy-two hours after the property owner receives written notice from the property and casualty insurer that the claim for payment for roofing work on the residential property is denied in whole or in part. The property owner's right of rescission under this subsection (1) does not apply when the property and casualty insurer denies, in whole or in part, a claim related to a request for supplemental roofing services if the damage requiring the supplemental roofing services could not have been reasonably foreseen as a necessary and related roofing service at the time of the initial roofing inspection or the execution of the initial roofing contract.

(b) The property owner shall give written notice of rescission of the contract to the roofing contractor at the physical address provided in the contract within seventy-two hours after he or she is notified of the denial. The property owner may give notice of rescission of the contract:

(I) In an electronic form, which is effective on the date of the electronic transmission;

(II) By mail, which is effective upon deposit in the United States mail, postage prepaid, sent to the physical address stated in the contract; or

(III) By personal delivery to the roofing contractor, which is effective upon delivery.

(2) Within ten days after rescission of a contract in accordance with subsection (1) of this section, the roofing contractor shall return to the property owner any payments or deposits made by or evidence of indebtedness of the property owner in connection with the contract for roofing work on the residential property.

(3) Nothing in this section precludes a roofing contractor from retaining all or a portion of any payments or deposits made by a property owner to compensate the roofing contractor for roofing work actually performed on the residential property in a workmanlike manner consistent with standard roofing industry practices, but the roofing contractor may retain only an amount required to compensate the roofing contractor for the actual work performed.

(4) Nothing in this section abrogates the roofing contractor's right to pursue common law remedies for the reasonable value of roofing materials ordered and actually installed on the residential property pursuant to a contract for roofing work before the property owner rescinded the contract, as long as the roofing contractor performed the roofing services consistent with roofing industry standards for workmanlike performance of roofing services.

(5) Nothing in this section abrogates a property and casualty insurer's duties, responsibilities, or liability under sections 10-3-1115 and 10-3-1116, C.R.S.

Source: L. 2012: Entire article added, (SB 12-038), ch. 267, p. 1388, § 1, effective June 6.

6-22-105. Waiver of insurance deductible prohibited. (1) A roofing contractor that performs roofing work, the payment for which will be made from the proceeds of a property and casualty insurance policy issued pursuant to part 1 of article 4 of title 10, C.R.S., shall not advertise or promise to pay, waive, or rebate all or part of any insurance deductible applicable to the claim for payment for roofing work on the covered residential property.

(2) If a roofing contractor violates subsection (1) of this section:

(a) The insurer to whom the property owner submitted the claim for payment for the roofing work is not obligated to consider the estimate of costs for the roofing work prepared by the roofing contractor; and

(b) The property owner whose residential property is insured under the property and casualty insurance policy or the insurer that issued the policy may bring an action against the roofing contractor in a court of competent jurisdiction to recover damages sustained by the property owner or insurer as a consequence of the violation.

(3) A roofing contractor soliciting roofing services in this state shall not claim to be or act as a public insurance adjuster adjusting claims for losses or damages. Nothing in this article prevents a public insurance adjuster licensed pursuant to section 10-2-417, C.R.S., from acting or holding himself or herself out as a public insurance adjuster. Nothing in this subsection (3) precludes a roofing contractor from discussing, on behalf of the property owner, the scope of repairs with a property and casualty insurer when the roofing contractor has a valid contract with the property owner of the residential property on which the roofing contractor has contracted to perform roofing work.

Source: L. 2012: Entire article added, (SB 12-038), ch. 267, p. 1390, § 1, effective June 6.